AREF

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19 January 2017

Rt. Hon. Philip Hammond MP
Chancellor of the Exchequer
Her Majesty's Treasury
1 Horseguards Road
London SW1A 2HQ

REPRESENTATIONS FOR BUDGET 2017

I am pleased to enclose the Association of Real Estate Funds' representations for the 2017 Budget.

The Association of Real Estate Funds (AREF) represents the UK real estate funds industry. It has about 65 members with a collective net asset value of around £65 billion under management on behalf of investors. This includes around £20 billion in UK authorised retail funds and similar amounts in various forms of UK unregulated collective investment vehicles (CIVs) and in offshore domiciled funds. Member funds represent about two-thirds of UK commercial real estate held in CIVs.

We are pleased that the Government has enacted a seeding relief in FA 2016 to enable institutional investors to transfer seed portfolios of UK properties in to CoACS and PAIFs without an immediate liability to SDLT arising. However, we are concerned that the effect of the claw-back may be to create liabilities to SDLT in circumstances where it is not appropriate. We therefore believe for the reasons set out in the attached Appendix that there is a strong case for both unit-linked funds and the Local Government Pension Schemes to be removed from the scope of the claw-back rules.

Brexit will result in an uncertain business landscape for some time, during which maintaining the UK's attractiveness as a place to do business is more important than ever. With that in mind in addition to the amendments to the claw-back rules we support an exemption from the additional 3% SDLT charge for large scale institutional investors.

We are pleased that extremely good working relationships have developed with your officials over the last few years. Debates have been conducted in an open and transparent manner, and it is clear that your officials have developed an extremely good understanding of the commercial drivers which impact the industry. Within the policy guidelines set by Ministers,

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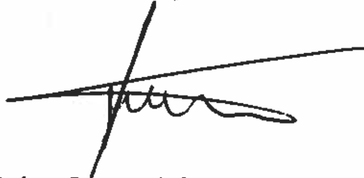
officials have shown themselves enthusiastic in seeking to help the industry. This relationship has proved extremely valuable for the industry and we look forward to a continuing open dialogue.

If there is any further information that you need, or any more detailed analysis, before considering our representations please let me know.

Yours sincerely,



John Cartwright
Chief Executive

AREF

Association of Real Estate Funds

REPRESENTATIONS FOR THE CHANCELLOR'S

Budget 2017

SDLT Seeding Relief Claw-back: PAIFs and CoACS

We are pleased that the Government has enacted a seeding relief in FA 2016 to enable institutional investors to transfer seed portfolios of UK properties in to CoACS and PAIFs without an immediate liability to SDLT arising. The relief essentially allows prospective investors to transfer their existing portfolios in to two tax-effective types of UK collective investment scheme. The Government was concerned to avoid any possibility of the relief being used to avoid tax in circumstances where it should be paid and, as a result, has introduced a claw-back mechanism to catch situations where an institution seeds a vehicle and then disposes of the resulting units within a period of up to four and half years. While we understand the Government's need to protect the tax base from unintended erosion, we are concerned that the effect of the claw-back may be to create liabilities to SDLT in circumstances where it is not appropriate.

Of particular concern are unitised life policies where the claw-back can arise without any intervention or intent by the seed investor or operator of the CoACS or PAIF. Here it may make commercial sense for the life company to establish a CoACS or PAIF and seed it by transferring existing property pools in to it. This is likely to occur where it is commercially desirable and in the interests of unitised policyholders to transfer property assets of a life company to a CoACS or PAIF to allow distribution on a wider scale thus facilitating growth opportunities and enhancing diversification benefits for policyholders in the process. Another example would be where a life company has grown by acquisition of rival companies with the result that there is replication of products across the various companies in the group. It is often in the interests of the unitised policyholders throughout the life company group for the various companies to aggregate their smaller property portfolios into a single large portfolio which can then afford to invest in larger, better-quality assets. While life company groups could create a CoACS or PAIF as a property pooling vehicle without any liability to SDLT unfortunately, because of the risk of the claw-back being triggered by policyholders redeeming (something which is outside the control of the life companies) it will not generally be possible for the life companies to take the risk.

Another situation relates to the Local Government Pension Schemes ("LGPS") which the Government has mandated to pool their assets into substantial pools and many of the resulting pools are intending to use either CoACS or PAIFs to do so. If the LGPS use the statutory seeding relief for this purpose and they then need to sell some or all of the resulting units/shares they have received in exchange within the 'control period' (a three-year period following the seeding period of up to 18 months) for asset allocation or any other reason then, depending on the value of the units/shares at the time and other facts and circumstances, this could trigger a claw-back charge to SDLT. It is not appropriate for the Government to mandate pooling and then benefit from a charge to SDLT triggered as a result of it and which would not have arisen if the LGPS had retained direct ownership of its property portfolio and divested itself by the

same amount for asset allocation or other reasons. SDLT will in any event be triggered for the buyer in the normal way at the point that a property is sold out of the LGPS pool so there can, for an exclusively LGPS pool, be no loss of SDLT that would otherwise have been received by the Exchequer. It is not expected that units in the LGPS pool will be available outside the relevant group of local government pension schemes and so there will be no risk of outside investors gaining an interest in the property subject to the scheme except by the purchase of the property from the scheme.

<u>We call for an exemption from the SDLT claw-back provisions for both unit-linked funds together with the LGPS.</u>

Increased SDLT for second homes and buy-to-let properties

We acknowledge the government's desire to support widespread home ownership. However, features of the additional 3% SDLT charge can have adverse effects on large scale institutional investors in UK residential property. Which in turn can affect the supply of new housing stock. We support an exemption from the charge for those institutional investors that contribute to the delivery of new stock.

Multiple dwellings relief was originally introduced so that institutional investors would pay SDLT at rates equivalent to individual purchasers. The relief sets the rate of SDLT payable by reference to the average value of the units purchased. Multiple dwellings relief still applies but its effect has been severely limited due to the new additional 3% rate. For an institutional investor forward funding the development of a residential block where the average value of a unit is £250k or less, SDLT costs will have increased by up to 3%. In many circumstances the scheme may no longer be viable as a result. Where the average value of a unit is greater than £250k, multiple dwellings relief is of no benefit. An investor would then treat the transaction as a deemed commercial transaction and pay at the commercial rates, provided that they are acquiring 6 or more properties.

This issue would be solved by including a genuine diversity of ownership ("GDO") test in the legislation. Such a test currently exists for the non-resident capital gains tax and the rules could equally be applied to SDLT. Broadly where a purchasing entity is widely held it would not be subject to the additional 3% rate of SDLT. Institutional investors such as pension funds are deemed to be widely held for the purposes of the test.

Note that this proposal is different to the portfolio exemption consulted on and rejected earlier this year. Under that proposal an exemption would apply where the investor held a portfolio of 15 of more properties. Unlike the GDO test a portfolio exemption could easily be exploited by high net worth individuals.

<u>We call for an exemption from the additional 3% SDLT charge for institutional investors by inserting a GDO test.</u>