AREF
The Association of Real Estate Funds

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Response by email to rpdtconsultation@hmtreasury.gov.uk

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To whom it may concern

Association of Real Estate Funds response to HM Treasury's Consultation on the Residential Property Developer Tax

Introduction

We, the Association of Real Estate Funds[1] (AREF) welcome the opportunity to respond to the government's consultation on the Residential Property Developer Tax (RPDT). In our response we have deliberately not addressed the detail of every question raised in the consultation, but focus here on points of principle in the terms of the intended scope of the tax.

The aim

AREF agrees that there is a crucial need for the government and other relevant parties to address as quickly as possible the issues of cladding remediation and other building safety measures that have come to the fore in particular following the Grenfell Tower tragedy and to help restore confidence in the market of the affected leaseholders.

AREF's concern

Our concern, however, is in the proposed scope and form of how it proposes to do that in the RPDT, noting the government's concerns for fairness and, crucially here, the continued and increasing need to maintain and bring forward delivery of housing stock across all the tenures, from build-to-rent, build-to-sell and affordable.

AREF's view

AREF is firmly of the view that the proposed scope of the RPDT is mis-targetted and in danger of jeopardising the future source of capital into the UK housing market and the supply of housing, such that the meeting of housing targets will slip even further and exacerbate consequential issues across the country.

In particular, it is our view that to ensure that the housing sector is not adversely affected, the scope of those proposed to be caught by the charge is too wide and it should not apply to the following categories:

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[1] The Association of Real Estate Funds represents the UK real estate funds industry and has around 60 member funds with a collective net asset value of more than £72 billion under management on behalf of their investors, including £18 billion on behalf of retail investors in the UK. The Association is committed to promoting transparency in performance measurement and fund reporting through the AREF Code of Practice, the AREF/IPD UK Quarterly Property Funds Index and the AREF/IPD Property Fund Vision Handbook.

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- build-to-rent,
- purpose-built student accommodation (PBSA),
- care homes for rent and or with support, and
- affordable housing in any form, whether developed for profit or by not-for-profit registered providers, including
- market sale and rent housing developed by not-for-profit housing associations.

Collectively we refer to these below as the build-to-rent sector.

Rationale for AREF's view

The rationale for the AREF view is set out below.

We are conscious that the government generally like to receive anecdotal evidence behind industry positions and to help it to come to its own view. In helping AREF to arrive at its conclusions reflected here, we have, therefore, in addition to reflecting the views of AREF members, included some findings from a survey of the Investment Property Forum (The IPF Survey). 28 institutional investors participated in The IPF Survey; they currently invest over £25bn in UK residential assets in the build-to-rent and PBSA sectors and plan to invest another £13.9 billion in the sector over the next three years. We understand that IPF submitted a copy of the Survey questions and findings to HM Treasury in mid-July 2021.

1. **What the institutional build-to-rent sector is seeking to achieve**

   The aim of the growing institutional build-to-rent sector in the UK is to provide good quality long-term housing for its tenants and to incentivise those tenants through good landlord behaviour and good quality accommodation, increasingly across the whole country and with various pricing points. It has a strong ethos of compliance and of building sustainable models for the housing sector and is working hard toward net zero carbon and other goals and good standards of environmentally friendly behaviour and governance. The sector has the benefit of a counter-cyclical model that can provide such housing relatively quickly and on a large scale at once both in recessions as well as at the top of the market. It provides generally stable returns effectively hedged against wage inflation for its investors, but those returns in terms of ongoing yields are relatively low compared to other products. The government's housing target is a long way from being met. The build-to-rent sector is key to this.

2. **New tax is not "fair" in the proposed scope**

   We understand that the government does not wish to impute responsibility for the cladding crisis by the new RPDT and needs publicly to be seen to be doing something to assist adversely impacted leaseholders. We agree with this. However, we believe that inclusion of the build-to-rent sector within the scope of the RPDT is mis-targetted and in danger of creating other long-term negative impacts for the housing sector and so for the government. It does not appear "fair", therefore, that it should be within scope.

3. **Negative impact for the sector**

   The sector clearly would be impacted negatively by the proposals. The IPF Survey indicates that potentially three quarters of its respondents believe they would be caught by the proposals, with the majority of those believing that the tax would have significant implications for the residential market (this is discussed further below).

4. **No burden on tenants in build-to-rent models**

   Specifically addressing the points raised in the consultation document, the financial crisis for leaseholders affected by the cladding crisis, is not one that affects tenants in build-to-rent properties. Here, those tenants pay rent (based on prevailing market conditions) and the burden of the cost of remediation works (rightly) falls on the build-to-rent landlord. A landlord that sought to raise rents to recover these costs would quickly lose tenants.

5. **No responsibility for the crisis**

   We understand that the government does not want to impute responsibility for the cladding crisis through very targetted measures and accept that. However, taking into account the 28 responses to The IPF Survey, those in the build-to-rent sector either have already remediated any affected properties or are in the course of doing

so at their own or at the expense of someone other than the tenants. Indeed over 2/3 of those who responded to The IPF Survey had no cladding issue at all.

6. **No benefit from government support**

More particularly - contrary to what is inferred in the consultation document - the build-to-rent market has not generally benefitted from the support that the government has provided to industry to assist with cladding remediation or from the benefits offered to homeowners (and so the build-to-sell market) in the form of the recent SDLT or mortgage reliefs on their build-to-rent assets[2]. So, the purported "fairness" in applying the charge to the build-to-rent model is not supportable[3].

7. **Double counting / triple counting**

As indicated above, the build-to-rent sector has remediated or is continuing to remediate any properties it owns without recourse to the tenants. Imposing another charge as here would, effectively be a double hit. Should costs to any intermediate developer – say in the popular golden brick scenario be passed on through the pricing to the build-to-rent investor (as is anticipated) this would in fact be triple counting.

8. **Deterrent effect on large scale funding to help meet the housing need**

The build-to-rent model is not yet mature.[4] There is still a shortage of large scale modern stabilised assets available. Estimates, based on industry responses obtained by the IPF, are that market maturity is some 5-10 years away.[5] These estimates were before this tax was announced and so should be considered again in that light. It is vital, therefore, for the market to continue to thrive at this stage for it to be able to raise the necessary substantial, large-scale institutional capital to build new all the necessary projects to get to the right targetted housing levels and to the right type and quality of stock. The inclusion of these projects within the scope of the new RPDT, as currently proposed, would be a deterrent to new investment. Investors need to know that they can get the right return. Investment has to be financially viable and competitive - too many uncertainties and reduced opportunities or returns and investors will invest their money elsewhere. Notably here, The IPF Survey indicates that, as a result of the RPDT, over 60% of respondents would reduce their exposure to UK residential. Reasons included the increased difficulty in attracting investors as a result of the tax, constrained margins, international competing products for their investments and increased difficulty in sourcing good assets with more constrained resources.

9. **Key to continue to attract international money to the UK housing market**

Much of the institutional money coming into the build-to-rent sector is from large international investors. For them, while they are attracted to the sector for a variety of reasons, at the end of the game, it is just a financial asset. For the UK housing market, it is, however, key to be able to continue to access this new source of capital to provide funding to build more good quality homes. An additional tax burden on these international investors would result in investments being made outside the UK instead. In particular as the market is not yet mature, it is key not only to retain existing investors, but also to be able to continue to attract new investors.

10. **Not competing with the build-to-sell market**

The build-to-rent model and build-to-sell market are completely different; they are not competing. Indeed, they can sit side by side. Ultimately the question here is who bears and who can bear the cost and how the tax will impact on behaviour and government policy – in particular the need for new housing - elsewhere.

11. **Impact on the provision of large-scale housing projects**

So, AREF's key concern is the impact the RPDT, if applied to the build-to-rent sector, will have on the provision of good quality housing – in both the private and affordable sectors - in the UK going forward. As stated, 60%

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[2] Out of those who responded to The IPF Survey only 2 said they had benefitted from some government assistance and that this was on only a small number of legacy and not on their core build-to-rent assets. We are not aware of any AREF members benefitting from assistance.

[3] Furlough support may have benefitted some of the sector indirectly, but it was not targetted at the housing sector and so is not included here.

[4] Large2020 IPF Large Scale UK Residential Investment: Achieving Market Maturity Paper

[5] Large2020 IPF Large Scale UK Residential Investment: Achieving Market Maturity Paper

of those responding to The IPF Survey said that they would reduce their exposure to the UK residential market as a result of the proposals. That is a lot of lost investment and likely to result in fewer homes. Another 25% of the respondents said that they would change their proposals, including the type of residential assets being invested in and reduce the affordable element to improve viability. It is key that affordable housing is not affected. We have not met anyone who would disagree with that idea, but it is a real concern that this could be the consequence in practice.

12. **Misconceived avoidance measures**

    We note that the government is concerned that the charge could be avoided in some way – maybe by intra group leases or short leases – hence possibly the wider scope of including the build-to-rent sector in the first place. This cannot be the best approach if that is the issue. There are other mechanisms by which avoidance could be dealt with, rather than targeting the wider industry as a whole. Tools such as the longstanding distinction between trading and investment being one – a short lease would not turn a trading property into an investment one for example and other clawback mechanisms in tax or planning provisions exist also which could be utilised. Build-to-rent funds are clearly not trading.

13. **Key role in provisions of good quality long-term environmentally friendly housing**

    The government has focussed recently on promotion of home ownership. The build-to-rent model plays, however, a key role in providing good quality housing at scale and at pace for the future with large scale institutional investors dedicated to providing a good long-term service to their tenants. Indeed, it provides environmentally and socially beneficial accommodation across all the tenures across all the country -importantly also for those that cannot afford to or who may not wish to own their own homes. This sits easily alongside home ownership.

14. **Yet another negative blow to the industry**

    Quite apart from the fallout from Brexit and the increasing difficulty in raising funds from outside the UK, the UK build-to-rent sector has already been hit with a swathe of tax measures increasing the burden on the sector over the years – all of which affect returns and the perceived attraction of UK residential investment to non-UK investors. For example, we have the additional rates of SDLT on residential property generally, the additional 3% SDLT rate, the new 2% SDLT surcharge, the extension of capital gains tax to non-residents, interest and loss restrictions as a result of non-resident landlords coming into the UK corporation tax regime, not to mention the increase in the rate of corporation tax to 25% in 2023. On top of that there are already burdens for the build-to-rent sector that the build-to-sell sector does not suffer, such as lack of capital allowances and irrecoverable VAT on ongoing management fees, repairs and maintenance, a cost which is incrementally growing as good operators bring their models more in line with ESG and net zero carbon policies and so incur the resulting additional (and additional VAT) costs.

15. **RPDT proposals have a negative impact on the build-to-rent sector compared to the build-to-sell model**

    The whole design of the proposed charge, based effectively on a build-to-sell model, does not work for the build-to-rent market. In a build-to-sell model, the property will have been sold (or let at a premium) and there will be actual cash out of which to fund the charge. In the build-to-rent model, that will not be the case. There will be costs and uncertainties of valuation, then a charge operating on a deemed profit – which will give a dry tax charge – which will need to be funded. The impact of this will be to effectively pass the charge to investors, who came passively into a structure anticipating a certain return, or to result in a change of model.

16. **Build-to-rent landlords will be less able to benefit from allowances and timing**

    Under the build-to-rent model, a developer aims to bring its building to the market all at once, as quickly as possible in order to begin generating income for investors. This is of course a strength in its being able to provide housing more quickly. The build-to-sell model, generally staggers how it brings properties to the market to assist with pricing and should be able to use this same mechanism here to potentially help reduce the pressure on the charge by maximising the use of the £25m annual allowance across the several years of a development project. A build-to-rent project would complete its development over a much shorter period, with potentially more than one development completing at the same time and the ability, effectively, to spread use of allowances would be lost. Similarly, as the end of the time limited period of the tax approaches, developers

of build-to-sell projects may choose to defer completion until the tax no longer applies. The build-rent-model generally on the other hand needs to let as soon as possible to generate the necessary income returns.

17. **There are no grandfathering proposals**

    Those projects already underway will be caught, but funding for the charge will not have been taken into account when costing the project. However, simply deferring the charge until later is likely again to have a negative impact on investor appetite for the build-to-rent sector as by then they could see the impact on either returns and investments, so that is not an ideal solution. The build-to-sell sector is again more able to work with this.

18. **Impact of the charge on viability of existing and potential housing projects**

    The margins in much of the build-to-rent market are lower than elsewhere. This extra hit on returns is likely to make certain models unviable – this will mean that certain projects will not be carried out. This in turn will affect the housing supply.

19. **Negative hit on future housing supply**

    All of this would potentially simply have a negative impact on future housing supply or its quality none of which AREF wishes to see.

20. **Distorted knock on impact of the tax – a reversal of levelling up**

    A concern also is that, if implemented in the sector, the projects that prove less viable are likely to be those in less attractive markets where the commercial imperative is less compelling. Less money available also may mean less ability to provide the requisite affordable housing to the desired level.

21. **Market sale and rent housing developed by not-for-profit housing associations**

    Housing developments by not-for-profit associations should also be taken out of scope (as well as the affordable housing for rent models), as the proceeds cross-subsidise the charitable activity of these entities and in turn help to deliver more affordable housing.

22. **Retirement living**

    The provision of good quality homes in retirement and the release to the market of other properties for families is something that must be good. Likewise, the ability to access the right sort of care in old age. These are all socially acceptable and desirable and so we would like the sector – certainly where support is provided also to be out of scope

23. **Purpose-built student accommodation** (**PBSA)**

    The PBSA sector is very similar to BTR and the issues above apply likewise. This provides good quality housing – leaving others to other parts of the market - and its provisions plays an active part in place making. We cannot see why this should be in scope.

General comments on the consultation

As to the form of the tax more generally, we note that the British Property Federation (BPF) has done a considered response and we agree with the substance of this and do not propose to repeat it here, subject to a few general comments:

1. For a tax purporting to raise a comparatively small amount of money, it risks being disproportionately complex, with associated additional administrative costs – so increasing its effective burden. It needs to be easy to manage with low compliance costs and compliance risks.
2. If the aim is to create a level playing field for those in scope, maybe there is a simpler method that could be used eg a levy on new build properties sold or let could be simpler or maybe a specific rate of corporation tax on development sale profits?
3. Risks of avoidance should be kept in proportion. The government will know who the main likely taxpayers in scope are.

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4. The model for the RPDT should follow a corporation tax (CT) based approach, based on relevant residential activities rather than an entity or accounts-based approach. This is likely to be easier for most businesses work with and should only catch relevant activities.
5. We see no reason to disallow finance costs – this would effectively affect some business within scope more negatively than others – this does not seem fair. The CT system already includes comprehensive rules relating to the deductibility of financing costs which limit the amount of gearing to commercially sustainable amounts. These rules are incorporated into the financial modelling assumptions used by investors in their decisions. A tax charge applied to pre-interest profits will create significant volatility in the outcome for investors and deter investment.
6. To the extent REITs are within scope (and we suggest not on the build-to-rent portion of their portfolios), we suggest that the charge should be allowable as a deduction in computing the amount of the PID, such as not potentially to put REITs into a breach position.
7. There is a lot of detail to be sorted on joint ventures and how they operate, in particular where they may have mixed investors. There is no mention as to how it would apply to funds. However, this may not be an issue, should our suggestion about taking the build-to-rent sector out of scope as most funds will have investment models.
8. To the extent that the government has concerns about compliance and abuse, it already has well-trodden mechanisms to deal with this and some of these could be adapted as targetted measures here. We would be happy to discuss these with you as your thoughts progress.

Concluding comments

We hope the government is able to take AREF's views into account in the shape and scope of the new RPDT.

We would be happy to assist in any discussions if that would be helpful or if the government has any queries.

Should the government, contrary to AREF's suggestion, decide to retain the build-to-rent sector within scope, we would be happy at that stage to work with the government to help work out how it should apply to the sector and more particularly to the funds industry in its various forms.

Yours faithfully

Paul Richards
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