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HM Revenue and Customs
Enterprise and Property Tax team
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Be email: PropertyFundsSDLT.consultation@hmtreasury.gsi.gov.uk

Dear Sir/Madam

Stamp Duty Land Tax: rules for property investment funds consultation

The Association of Real Estate Funds (AREF) represents the UK unlisted real estate funds industry and has about 70 member funds with a collective net asset value of over £50 billion under management on behalf of their investors. These member funds represent about 75% of the UK commercial real estate held in Collective Investment Schemes (CIS) and includes £9 billion of net asset value in UK-authorized retail funds (NURS), £17 billion in various forms of UK Unauthorised Collective Investment Schemes (UCIS) and £14 billion invested in offshore (mostly Jersey) domiciled funds.

We welcome the opportunity to provide comments on this consultation. AREF is a strong supporter of the introduction of a Stamp Duty Land Tax (SDLT) seeding relief for Property Authorised Investment Funds (PAIFs) and of clarification of the SDLT treatment of and seeding relief for Co-ownership Authorised Contractual Schemes (CoACs) and has actively been involved in discussions with HMRC and HMT on the benefits of such relief and clarification for some time now.

We believe that one of the most significant barriers to the use of PAIFs as vehicles for property investment is the current SDLT charge imposed on the seeding of a fund. A seeding relief would enhance the effectiveness of the PAIF regime and would encourage the growth of the UK property fund industry through the launch of new property vehicles or the move of offshore property funds to the UK.

CoACs are also viewed by many as an attractive structure for holding real estate. Although it is currently possible to seed a CoACS SDLT free, any movement in the fund holdings would mean that ownership of the underlying property would change and this creates SDLT charges for whoever has an increasing share of the fund. We therefore support the Government's proposed treatment for the SDLT treatment for CoACs which we believe will encourage the industry to use these vehicles for real estate investment.

A seeding relief will help meet the Government's objectives expressed in its Investment Management Strategy by enhancing the competitive position of the UK property fund industry.

We support the design features of the relief outlined in the consultation document, subject to our comments in relation to the claw back provision and the thresholds.

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Although in many circumstances a claw back would not be a significant impediment in using PAIFs and CoACSs, there are some improvements which could be made to enhance its effectiveness. This includes introducing a de minimis provision or introducing mechanisms to prevent a double SDLT charge.

We also believe the proposed thresholds would restrict the growth of the new property funds, by effectively excluding smaller managers who may not be able to seed a fund with assets valued at the suggested £100 million. We recommend removing the proposed value threshold.

We have responded to questions in the consultation document in the appendices. If you have any queries or require further information, please do not hesitate to contact me.

Yours faithfully

A handwritten signature in black ink, appearing to read 'John Cartwright', with a long horizontal stroke extending to the right.

John Cartwright
Chief Executive
The Association of Real Estate Funds



Appendix 1: Questions on existing structure

Question 1: *In your opinion, is the broad assessment of the structure of the property fund market, including its size and the sorts of vehicles used, as set out above, accurate?*

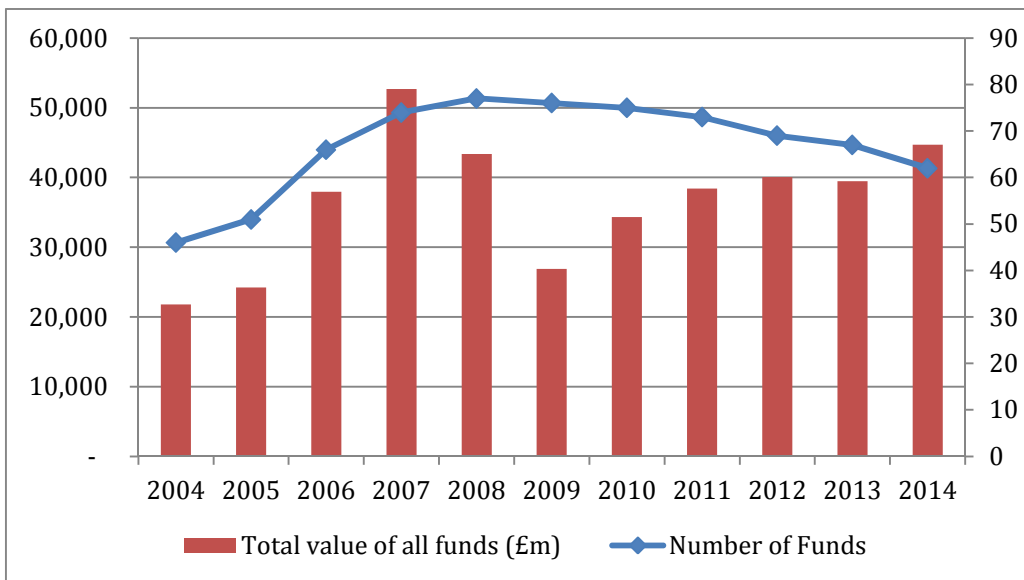
Based on data AREF has obtained from its membership we believe that the assessment of the property fund market is accurate.

Question 2: *In terms of both the number of funds and assets under management, what levels of growth have been experienced in recent years by the property fund industry? How does this differ from historical trends?*

The below graph indicates the growth of the property fund industry over the last ten years based on data used in the AREF/IPD Property Fund Vision Handbooks. The Property Fund Vision Handbook provides detailed information on 62 of the most regularly traded property funds managed in the UK.

Of these funds 38 are domiciled in the UK. The remaining 24 are domiciled offshore, 18 of which are located in Jersey. Of the UK funds, these predominantly consist of managed funds, unauthorised unit trusts, PAIFs and Limited Partnerships.

We estimate that the AREF/IPD Property Fund Vision Handbooks covers approximately 70% of the UK property funds industry.



Question 3: Other than existing investment funds, pension funds and insurance companies, what sorts of businesses and institutions currently hold sizeable property portfolios that might benefit from changes to the SDLT rules for PAIFs and CoACSs?

Investment funds, pension funds and insurance companies currently hold the majority of property portfolios. Realistically, the likelihood of other businesses or institutions holding property portfolios seeking benefit from changes to the SDLT rules will be limited.

Question 4: What are the main drivers for companies to transfer their assets into PAIFs or CoACSs? What benefits are expected to accrue as a result and to whom?

The majority of the assets that would be used to seed PAIFs or CoACSs are currently held by life companies or defined benefit pension schemes. There is a demand from these entities to move their direct property holdings into unitised collective investment vehicles that can be widely held.

There are a number of reasons for this. Many potential seed investors wish to be part of a wider and more diversified portfolio and so would like to use their existing assets to seed a new PAIF or CoACS in order to attract investment into these vehicles. Our members have indicated that one significant benefit that they would expect to see as a result of enabling the properties to be restructured into collective investment schemes is increased overseas investment into UK property funds.

We are also aware that if a seeding relief is introduced some managers would also wish to transfer assets from offshore structures into PAIFs or CoACSs. Managers have found that it is costly and time consuming to manage assets offshore, due to requirements of holding board meetings overseas and establishing a presence with qualified staff in different locations. The cost and time savings of running a fund in the UK plus the operational and compliance simplifications makes the option of transferring assets onshore very attractive to managers and these savings can ultimately be passed onto investors.

Question 5: The effect of making the changes discussed in this paper could potentially result in a large number of property funds being launched at the same time; is there evidence of significant investor demand for such funds that is currently not being met?

Until the PAIF regime was introduced there was no authorised fund vehicle specifically tailored for investment in UK property. This meant that in order to achieve tax transparency funds generally had to make use of offshore vehicles. The PAIF regime was specifically designed to fill this gap, but the lack of seeding relief has meant that PAIFs have not been utilised to their full potential and the PAIFs that were expected to be launched have not materialised.

Our members have informed us that investors are increasingly looking towards the UK as a place for investment and would therefore welcome the creation of new UK property funds. One of the reasons for this is that some investors would prefer to invest via authorised products such as PAIFs and CoACSs due to the superior protection UK regulation affords investors.

Furthermore, the use of these UK structures is widely regarded as an opportunity to attract a wider investor base outside of the UK. As the UK is recognised as a secure and stable place for property investment many European investors would also prefer to invest in UK property using UK vehicles as opposed to structures located in offshore financial centres.

Question 6: *Property funds pay SDLT when purchasing new properties; why is this less of a barrier to growth than the SDLT that would have been paid when assets are used to seed a fund?*

It is virtually impossible to launch a property fund “blind” (i.e. with no assets). It is therefore crucial to have a seed portfolio of existing assets which potential investors can use as a basis for making an investment decision. As prospective seed investors are likely to have already paid SDLT when they first purchased the seed property, it is economically not viable for them to pay SDLT on the same properties again. The fact a fund cannot be seeded using assets held by the same investors without incurring a further tax charge has been a major impediment to launching new authorised property funds in the first instance.

However, if a fund is able to be seeded in an economically efficient manner this will drive the future growth of the fund. Seed investors want their property to be part of a wider and more diversified portfolio so their intention is to use the seed assets to attract additional investment into the fund. The seeded fund will grow in size over time, resulting in an increased number of property transactions, each of which will incur SDLT.

Question 7: *Is there an urgent need for these changes to be introduced and, if so, what is driving it*

As noted in Question 6, without a seeding relief PAIFs and property CoACSs are unlikely to be launched in significant numbers. Our view is that the introduction of a seeding relief and clarification on the SDLT treatment of CoACSs would result in an increase in the number of property funds in the UK. The lack of such a relief has clearly contributed to why the PAIF regime has not been as effective as hoped.

We believe that now is the most opportune time to introduce a seeding relief. The Government’s announcement in Budget 2013 of its investment management strategy demonstrated its commitment to making the UK one of the most competitive places in the world for the investment management sector. A seeding relief would help the Government meet this objective by increasing the UK’s attractiveness as a destination for real estate development and investment. If these changes are not implemented the UK risks losing ground to other jurisdictions as a property fund domicile of choice.

Question 8: *If a seeding relief were introduced would your business or organisation expect to take advantage of it? If so, what quantum of assets would you expect to transfer into a UK collective investment scheme (and which type) and over what time period?*

We have asked our members to respond to the consultation with details of their specific intentions or circumstances.

Question 9: *Would the assets transferred be predominantly non-residential or residential UK properties? Are there any other types of assets your business or organisation might expect to hold in such funds?*

We have asked our members to respond to the consultation with details of their specific intentions or circumstances.

Question 10: How many new funds and of what typical size would your business or organisation expect to set up? How much growth would you expect to see in such funds in the future?

We have asked our members to respond to the consultation with details of their specific intentions or circumstances.

Question 11: Assuming a seeding relief enabled the movement of offshore funds onshore, would your business or organisation expect to redomicile any of your existing funds? What quantum of assets would you expect to be transferred into onshore funds as a result of potential changes?

We have asked our members to respond to the consultation with details of their specific intentions or circumstances.

Question 12: What extra economic activity (for example the effect on employment, savings or the property market) would result from holding property in PAIFs or CoACS compared to how they are currently held? Where funds are currently held offshore, would the impact be different? Would any economic activity be forgone?

In August 2013, AREF sent a questionnaire to its membership and the membership of the Association of British Insurers and the British Property Federation to collect data on the potential impact should a SDLT seeding relief be introduced, the results of which were provided to HM Treasury. Responses were obtained from 11 members who accounted for 75% of the UK property fund industry.

Broadly, the responses found that approximately £26.1 billion of property assets would be considered to launch new PAIFs or CoACSs and £6.61 billion of property would be considered to be transferred onshore into property funds if a seeding relief was introduced. This represents increased economic activity of £117.6 million per year, equating to approximately £42.3m of tax revenues.

In addition to the extra economic revenue holding property in these structures would yield, other industries including fund management and administration services, tax compliance and audit functions would also benefit from increased activity in the UK property fund industry as the management and administration of these funds would no doubt lead to an increase in employment in these fields.

Question 13: Do you foresee any further potential benefits, for example on other business sectors?

Please refer to our response in Question 12 above.

Question 14: What would be the downsides/risks/costs of making the changes mentioned? Could the introduction of a number of new funds being launched at the same time have a negative impact?

We don't foresee any potential disadvantages. As we have explained in question 5 above, there is a strong demand for UK property fund vehicles and a seeding relief and clarification of the SDLT treatment for CoACSs is a significant step in facilitating new launches of these vehicles.



Question 15: What would your business or organisation's likely response be if a seeding relief was not introduced or changes to the SDLT treatment of CoACSs were not made? What would happen to the property that your business or organisation is intending to transfer into a PAIF or a CoACS?

In general, the majority of our members have informed us that if a seeding relief is not introduced the majority of assets will remain in existing structures, i.e. predominantly life companies and defined benefit schemes. As a result of this it is likely that assets may decrease in size slowly over time as the funds which they back reduce in size. In addition, there is also a risk that if a seeding relief is not introduced some firms may transfer their assets into offshore vehicles and new funds may be structured using offshore vehicles

Appendix 2: Questions on the design of a seeding relief

Question 16: Is the potential design of a seeding relief appropriate for such a relief to be useful? If not, how and why would you like it to be changed or extended?

We note that if a relief was introduced it would only apply to the initial seeding of a PAIF or CoACS. It may be the case that for commercial reasons different properties cannot be contributed at exactly the same time. We recommend that there be a defined initial seeding period (for example, three to six months) to allow the seeder to contribute different properties within this initial seeding period.

Subject to our comments below regarding clawback and the portfolio test, we agree with all other aspects of the design of the relief.

Question 17: Would implementation of any of the features (alone or in combination) listed above cause a significant impediment to the use of these funds? Please explain why?

We note that the Government is considering introducing a provision to claw back the seeding relief in certain circumstances. It is unclear from the wording in the consultation how the Government intends the claw back to apply, i.e. at the end of the three years or during the three years. It would be helpful to have some clarification on this point.

Notwithstanding this, as it is currently drafted in the consultation document, although in many situations a claw back of the relief would result in a fair and equitable outcome for investors, there are some circumstances where this would not be the case. We have made some suggestions below on how the claw back mechanism could be improved to ensure that it achieves its purpose. AREF would be happy to discuss with HMRC the finer technical details of a claw back if this would be helpful.

If a claw back is introduced we would recommend that it may be beneficial to introduce some sort of de minimis limit so that there is a “buffer” before a claw back applies. An example of where this would be appropriate is where a new fund is seeded with property by a life company which is followed by cash subscriptions from outside investors. If the fund has difficulty in investing this additional cash in the market immediately, cash would typically be withdrawn by the life company. If there was a buffer, for example, of 25% of seeder units (over a three year period from seeding), which operated before a claw back applied, this would allow a small amount of proceeds to be paid out to the life company without triggering a claw back of SDLT.

In addition to this, there is a risk of double taxation in certain situations where the fund’s assets are sold in the market in order to fund the redemption of a seeder’s units. In this situation the purchaser of the assets will pay SDLT so there is a double charge if a claw back resulted in the seeder also incurring SDLT when those funds from the asset sale are used to redeem their units. This situation should be distinguished from the scenario where it is new investors in the PAIF which fund the redemption, in which case it is appropriate for the claw back to operate. One way to overcome this problem of double taxation would be to calculate the SDLT claw back so that is proportionately reduced by the SDLT payable on the assets sold to fund the seeder’s redemption.

A further example of where a claw back may be problematic is the situation where a life company distributes shares in a PAIF or units in a CoACS to policyholders as consideration for the transfer of real estate which they currently have an interest in via their policy.



A number of our members are interested in converting existing UK life insurance companies used as pension pooling vehicles into PAIFs or CoACSs. These funds hold significant amounts of real estate assets.

The funds are currently structured as life companies engaged in pension business which acquire assets. UK pension schemes and recognised equivalents purchase insurance policies from these life companies with the return under those policies being based on a defined pool of assets. The pension fund policyholders do not have any beneficial interest in the assets or in the life insurance company- they merely have a contractual right to returns from the assets.

These structures are costly to operate, require significant capital to be maintained and policies can only be acquired by pension funds or recognised equivalents which limits distribution opportunities.

Members would like to replace these arrangements with the result that policyholders become unit holders in a PAIF or CoACS holding the property assets. Economically it would be the same "investors" entitled to the income and gains on the same properties. The funds could then be marketed to a wide range of investors.

An SDLT seeding relief would help to facilitate this. The issue is, however, that units in the PAIF or CoACS would be issued to the existing life company and members would then want the units to be transferred to policyholders in exchange for cancelling their policies.

Under the current proposal this would create 100% claw back of the SDLT relief.

We would suggest that this is the sort of commercial transaction for which the SDLT relief should work. A possible solution could be an exemption on the immediate claw back on the transfer of units to unit holders, then the claw back could operate in the same manner but calculated by reference to when the policyholder sells down.

Question 18: Do the suggested minimum requirements for value and number of properties in the 'portfolio test' seem reasonable?

We do not believe there should be any minimum value imposed on the transferred properties. There are some smaller fund managers who are looking to potentially establish PAIFs or CoACSs with a smaller initial seeding, with the intention of growing the fund through additional investment. We believe a £100 million threshold will exclude many smaller managers from taking advantage of the relief as they will not have access to seed assets of this size.

We are also aware of the Government's desire to increase the flow of investment into residential property. Typically, funds created for the purpose of investing into the Private Rented Sector (PRS) will be seeded with assets of much less than £100 million but will have a significant amount of units on issue. As it stands, a minimum threshold of £100 million would limit the ability of PAIFs and CoACSs to be used as vehicles for investing into the PRS, thus creating a lost opportunity to advance the Government's goal of increased investment into residential property.

In relation to the number of properties, we recommend that the threshold for non-residential property be aligned with the PAIF rules. The PAIF rules require that a minimum of three



properties be held by the PAIF. We do not see any reason why the threshold requirements for a PAIF, and equally for a CoACS should be any different for the purposes of a SDLT seeding relief.

For residential property, we think that a 100 property threshold is too high. We understand the Government's concerns over the potential abuse of the rules, however we believe that a ten property minimum for residential property would be sufficient to alleviate any such concerns.

We also note that the Collective Investment Schemes sourcebook (COLL) contains investment limits for fund property holdings. Another alternative to the proposed thresholds in the consultation would be to set similar limits to the one in COLL which would ensure diversity of the fund.

Finally, it is not clear how the thresholds would apply if a seeder contributed both non-residential and residential property to a fund. We believe that clarification on how the rules would apply in this scenario is an issue that needs to be addressed.

Question 19: Are there additional risks of avoidance that the safeguards described above do not address? Would any other conditions be helpful in preventing the relief being used in undesirable or unintended way?

We do not think that there are any additional risks of avoidance that the suggested safeguards do not address.

Question 20: What would be the implications of the seeding relief applying to equivalent foreign funds? Would this have any effect on the domicile of the fund you would transfer your property portfolio to?

In principle, we do not have any problems with the relief applying to equivalent foreign funds, however, this would depend on the definition of an "equivalent foreign fund". The wider the definition is, the higher the risk that more offshore funds will be utilised as vehicles for UK property investment instead of UK funds. This obviously would have a detrimental effect on the expected economic benefits we had anticipated accruing to the UK as a result of a SDLT seeding relief.



Appendix 3: Questions on the SDLT treatment of CoACSs

Question 21: Would the proposal outlined here be a viable option to achieve fair SDLT treatment of property acquired by and held in a co-ownership scheme? If not, how and why would you like it to be changed?

We agree with the proposed treatment. As there is significant interest in launching property CoACSs it is vitally important that the SDLT treatment for CoACSs is clarified irrespective of whether or not a seeding relief is introduced for PAIFs. At present the administrative difficulties associated with the current SDLT treatment of a CoACS means it is commercially not viable to use these vehicles for holding property. The changes suggested by the Government are reasonable and will go a long way in ensuring the success of the CoACS regime.

Question 22: Would a seeding relief as described in Chapter 3 be tenable for CoACSs?

Our comments in questions 17 and 18 apply equally to CoACSs.

Noting our comments on the removal of a minimum value threshold, we also suggest if there was to be a minimum threshold, this should be combined across the sub-funds. For example, if £50m property is put into a retail fund and £50m into an institutional fund, this should satisfy the £100m threshold.

Question 23: What would be the implications of the same SDLT treatment applying to equivalent foreign funds? Would this have any effect on the domicile of the fund you would transfer your property portfolio to?

Our comments in question 20 apply equally here.