

Press Release



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Relaxed investment rules could bring more new homes

Overly restrictive investment rules are discouraging investment in new homes, a new report from the commercial property industry has warned.

It calls on the government to amend regulations on real estate investment trusts (REITs) to encourage more of these tax-efficient companies to be formed to improve residential property investment. REITs would help the creation of a large, corporate rental sector which the industry believes could contribute to easing the housing crisis.

While demand may exist for 240,000 homes a year, this does not mean 240,000 families can actually afford new homes.

Housing affordability is driven by the dwindling supply of credit – rather than simply by the supply of houses – and the property industry believes the government must do more than set increased house building targets.

The report from the Property Industry Alliance (PIA) analyses the REITs market one year after they were introduced, and sets out what needs to change.

The PIA is concerned that the market will stagnate unless the government reduces the barriers preventing the creation of new REITs. Of the 18 REITs that currently exist, 16 are existing companies that converted to REITs and only two were created from scratch.

The report calls on the government to take action to encourage new REITs to emerge, to increase the likelihood of the development of a residential REIT sector and to allow unlisted REITs.

Gareth Lewis, director of finance and investment at the British Property Federation, a member of the PIA, said: “We believe that the commercial property industry could play a very valuable role in helping the government to meet its target for new homes.

“REITs could play a major role in the provision of high quality rented homes for those who can’t afford to buy their own and don’t qualify for social housing. This professional rented sector is very large in the USA and on the continent but is less of a dominant force in this country.

“However, to encourage more companies and institutional investors to invest in the professional rented sector, we think government should proactively look to lower the barriers to entry so that new REITs emerge that invest in homes as well as in offices, retail and industrial property.

“Encouraging the creation of residential REITs is not the only way to bring this about, but would signal the clearest message of intent by Government to make it happen.”

Contact Andrew Teacher, media manager on 020 7802 0113 / 07968 124545 / ateacher@bpf.org.uk

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Glossary and notes

Property Industry Alliance

The PIA is an alliance of four trade bodies – the British Property Federation (BPF), British Council for Offices (BCO), Investment Property Forum (IPF) and the Royal Institution of Chartered Surveyors (RICS) – that work together on issues of mutual concern.

REITs

A REIT is a method of indirect property investment, which more closely replicates direct investment in property by removing the tax charge at the company level. Distributions from REITS are taxed according to the tax status of the shareholders

Supply and demand of homes

While there may be demand from potential home occupiers for 240,000 homes a year, that does not mean that there are 240,000 families able to afford their own homes. And with housing affordability driven by the dwindling supply of credit, ministers must therefore look for other solutions to Britain's housing needs. REITs would encourage vital new investment in housing, providing a professionally rental sector giving people security of tenure without the risk of repossessions or spiralling debts.

It is widely accepted that corporate residential investment and ownership could improve efficiency in housing by adopting the business models used for running offices and shopping centres. This has worked across America and Europe where consumers enjoy long term lettings rather than the one year average we have in the UK. They also enjoy the same level of service – such as concierge and maintenance - that commercial tenants receive when renting offices.

Long-term stability

The move could help improve market stability in housing, as REITs would tend to invest at different points in the property cycle to buy-to-let investors.

Securing the long term health of the residential market would also improve confidence across the wider economy. A REIT-based structure is potentially the most suitable listed vehicle for large corporate investment in residential property.

Investors generally put money into offices and retail because they provide generous rental incomes. Residential property on the other hand, provides historically less generous rental streams but lucrative capital returns. A change of government policy on housing could lead to changes in the way investors see residential investments.

The PIA report calls for the government to make various changes to legislation:

Removing barriers to new investors

In order to become a REIT, a company must first be listed on a recognised stock exchange and then pay a 2 per cent charge based on its gross assets. While this is generally fine for large, established firms already listed, for newer firms it can prove one charge to far amid a minefield of other set-up costs.

Property portfolios and companies that are not already listed and who may be just starting out have to incur numerous costs from structuring the company to listing on the LSE, paying 4 per cent stamp duty when acquiring their property and then converting to a REIT at a cost of 2 per cent.

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While there are ways to minimise these costs, the sheer number of different charges nevertheless acts as a disincentive to new investors.

What changes will help a residential REIT come to market?

The government must align current REIT legislation more closely with the residential business model. It needs to provide a more level playing field with the commercial property sector to bring investment into housing supply.

It can do this particularly by amending rules on stamp duty, VAT and restrictions on borrowing.

Stamp duty

Stamp duty on property investments is charged on the total value of the purchase rather than the individual items bought. So if a big investor buys ten properties at £250k it will pay the full rate of stamp duty of 4% on the total value of £2.5m, which works out as £100k. However, if these ten properties were bought individually as would normally be the case for a smaller buy-to-let investor, they would only incur a 1% stamp duty charge of £2.5k for each property – a total cost for the 10 properties of £25k.

Generally, a buy-to-let investor would only purchase one property at a time and would therefore benefit from paying the lower rate. The industry wants these rules to be levelled out to help encourage greater corporate investment.

VAT

Similarly, residential property companies have difficulty recovering VAT on costs associated with managing property and therefore VAT remains an additional cost for the landlord. This could be addressed by reducing or exempting VAT on residential maintenance and refurbishment.

Borrowing restrictions

Current rules state that a REIT's taxable profits must exceed interest payments by 1.25 times. But with residential investments having a much lower income yield compared with offices and retail – as most of their profit has historically come from capital value increases - this requirement places a disproportionate burden on residential REITs compared with higher yielding commercial REITs.

What changes are needed to ensure the emergence of a large scale professionally managed residential sector in the short/medium term?

The industry wants ministers to seriously consider legislation to encourage the transfer of privately owned residential property from the highly fragmented private rental market (currently estimated value of £280billion), into a larger scale residential REIT market.

Proposals for consideration include the ability for buy-to-let landlords to transfer their properties and mortgage into a REIT in exchange for shares in the REIT, without triggering an immediate tax charge. The tax on the capital gain could be deferred until the buy-to-let landlord sells his shares in the REIT. This proposal also avoids the need to raise significant fresh equity or debt, both of which could be difficult to obtain in the current climate.

Once a residential REIT market of sufficient size emerges, market forces will allow for its natural growth and development - as institutional investors would have access to a residential investment market with sufficient scale and liquidity to allow them to make more appropriate capital allocations to

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the residential sector.

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Notes for editors

The original Government objectives for the introduction of UK REITs cited the benefits that a residential REIT market could provide to the UK housing model. In its consultation document “Promoting more flexible investment in property”, the Government stated:

The Government believes there is great potential to increase corporate and institutional investment through a PIF, in order to raise standards in the rented sectors, and provide an alternative to the highly geared buy-to-let market. It is also keen for a PIF to stimulate greater development activity in the residential market providing a vehicle into which new properties can be converted and managed more efficiently.

Accordingly, the lack of residential REITs is a concern that Government wishes to address. The PIA paper considers this concern in the context of the health of the residential sector in general rather than simply from the point of view of encouraging the emergence of residential REITs for the sake of being able to satisfy the original “scorecard” objectives for UK REITs.