GERALD EDELMAN

January 2021

The Property Round

In This Issue

This Issue's Contributors

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GERALD EDELMAN

EDITORIAL

Happy new year and welcome to the second edition of our property newsletter.

What a year 2020 was. The disruption and uncertainty caused by the coronavirus and Brexit impacted so many people in the sector. Consequently, the market slowed at the beginning of 2020, but with government interventions, such as the temporary suspension of stamp duty land tax, it was promising to see the market recover and grow again from the middle of 2020.

Now we look forward to 2021 and what the year will bring. One of my first jobs this year will be to edit the VAT section in the Law Society's Conveyancing Handbook, which is published on an annual basis. This book covers the VAT treatment of, amongst other things, residential and commercial property, land, the option to tax, conversions and property sold as a going concern. This really gives me an excuse to separately review all the relevant changes in the VAT rules over the previous twelve months that relate to land and property to ensure this is incorporated into the text. It is therefore a good opportunity to take a step back and review all property updates from HMRC and make sure that I, and my team, are up to speed with all developments in the real estate sector.

2021 will be an interesting year with a couple of issues at the forefront of my mind – Brexit and the Domestic Reverse Charge (DRC) for the construction industry. As the introduction of DRC has already been delayed a couple of times, I am not holding my breath that this will actually happen on 1 March 2021 as currently expected. If it actually does come into practice, then I will undoubtedly produce an article on this in the next edition of this newsletter as well as including relevant details in the Conveyancing Handbook.

Despite the challenges of Brexit and the coronavirus, optimism remains strong in the sector, which is clear from our features with industry experts in the lettings, commercial and residential sector who provide their insight into the industry, the performance and outlook for 2021.

Should you have any feedback on our property update or would like to contribute to our next edition we would love to hear from you.

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PROPERTY SECTOR UPDATE

What began as a disastrous year for the property industry in 2020 dramatically changed towards the end of the year.

At the beginning of 2020, growth in the property market was slowing, driven by uncertainty over Brexit and the strict lockdown measures introduced in March 2020.

However, since lockdown measures were eased in May 2020, the residential property market has experienced a 'mini boom', with estate agents reporting a jump in activity, fueled by pent-up demand. A further catalyst was added in July 2020, when the government announced a suspension of stamp duty on the first £500k of residential property purchases until March 2021 and, as a result, the industry has seen a significant spike in enquiries and transactions.

HOUSE PRICES

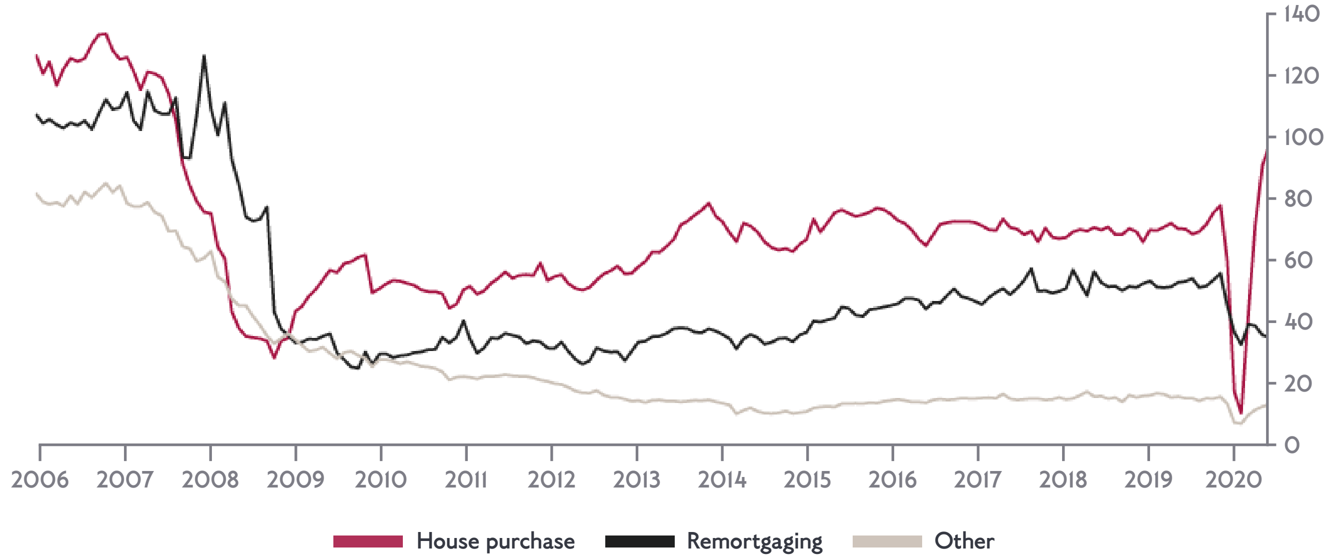
Since 2016, house price growth has slowed, largely a result of the uncertainty surrounding Brexit. However, the start of 2020 saw a pickup in annual growth. Despite a drop in average house prices in April 2020, reflecting the effect of the lockdown measures on the market, the average house price in the UK has continued to rise in the rest of the year, with **house prices in October 2020 up 5.4%** in the 12 months then ended, according to data published by HM Land Registry.

AVERAGE HOUSE PRICE, UK, JANUARY 2005 TO OCTOBER 2020

Source: HM Land Registry – UK House Price Index

CHART 1: MORTGAGE APPROVALS

SEASONALLY ADJUSTED



Increasing house prices since April have been attributed to three things: pent up demand, changes in housing preferences (demand for properties with gardens and green spaces has increased), and changes in property taxation (a **temporary reduction in stamp duty rates has led to a surge in transaction volumes and sellers commanding higher prices).**

Experts believe that the uplift in housing activity is unlikely to be sustained in the long run. From March 2021, once the government's financial support schemes and stamp duty cuts end, it is likely that growth will stall or reverse altogether, with the **Centre for Economics and Business Research (CEBR) predicting a fall in house prices of 14% in 2021.**

THE COMMERCIAL SECTOR

Retail

The impact on the high street has been the most visible within the commercial property sector. With many high streets already in decline pre-pandemic, the coronavirus has merely accelerated this trend.

Despite six consecutive months to October 2020 of increasing retails sales, **since February 2020 in-store retail has suffered a 3.3% fall**. A behavioral shift from consumers to online shopping has boosted online sales by 52% across the period.

The retail property market is forecast to continue declining, with stores entering into administration, or unable to pay rent.

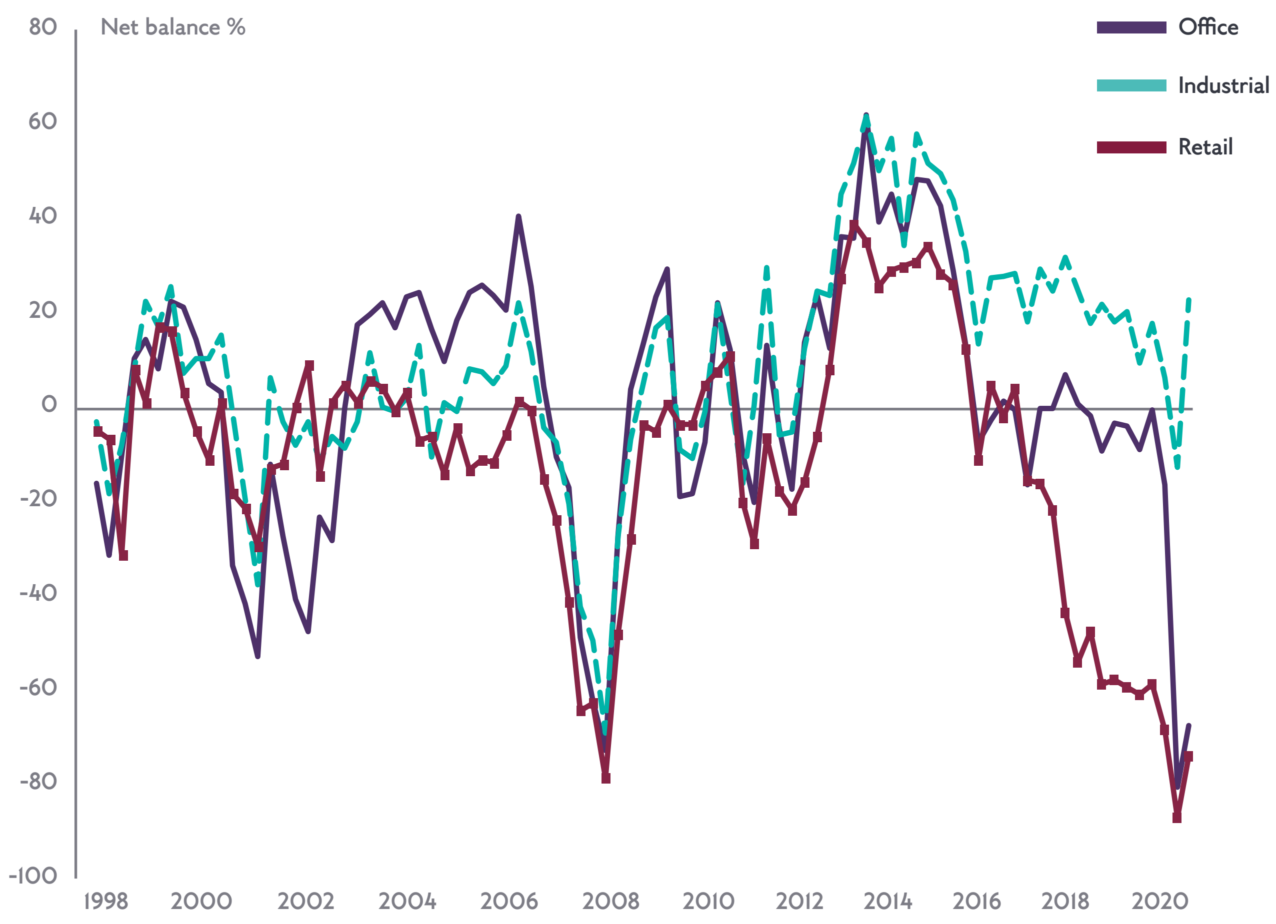
In November 2020, shopping centre landlord, Westfield, threatened legal action for retailers such as Pret A Manger and Hugo Boss over unpaid rent, whilst the Arcadia Group has entered into administration following the severe impact in their trading from lockdown measures, impacting over 450 retail units across the UK.

Office space

As employers and employees alike adapt to and embrace the 'new normal' of remote working, demand for office space is expected to continue to decline, with office space availability reportedly growing at its *fastest rate since 2009*. Whilst it is possible that opportunistic developers may see an opening to acquire and convert empty offices into residential properties, it is unlikely this will completely offset the decreased demand for these spaces.

It is expected that there may be a shift in businesses moving to smaller offices, or looking at alternative, flexible rental options both in cities and within their employees' local areas.

OCCUPIER DEMAND



Warehouses and logistics centres

In contrast to the above, companies utilising these properties have experienced a surge in demand, with many looking to grow and expand. **With the trend towards online shopping expected to continue in the long run, the demand and price of these spaces are expected to continue.**

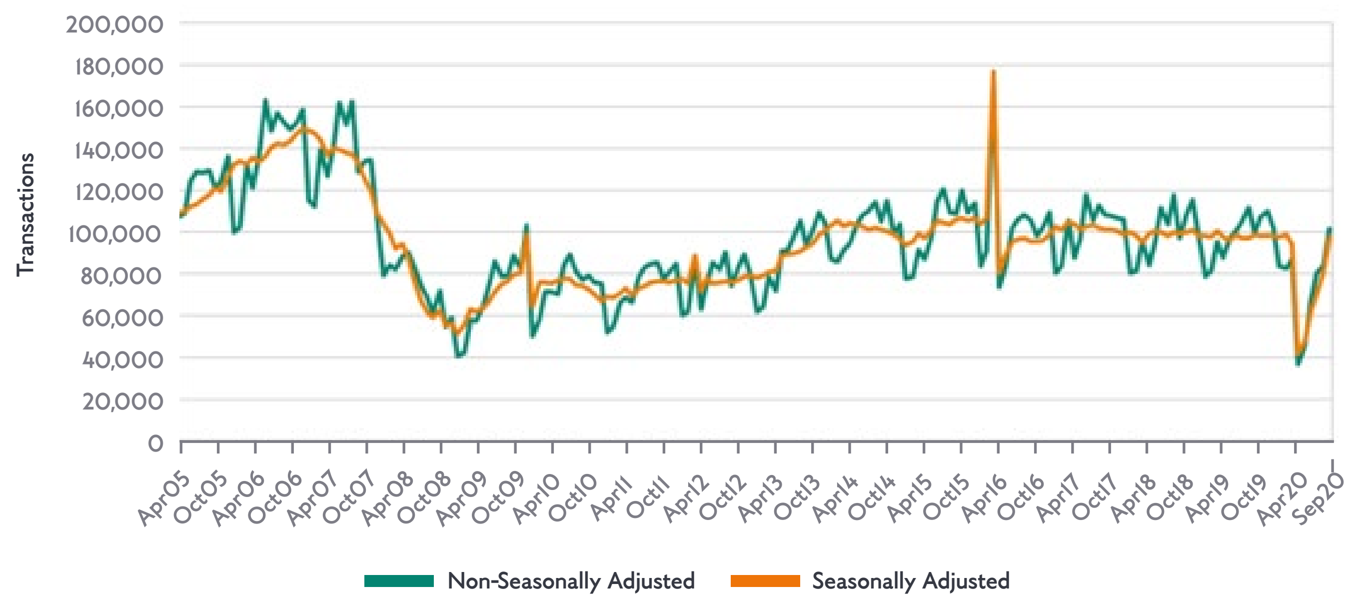
> Since February 2020 in-store retail has suffered a 3.3% fall

PROPERTY SERVICES

Estate Agents

Despite a significant drop in residential transactions in April 2020, since May 2020 transaction volumes have been increasing. According to HMRC data, the number of residential transactions completed in September 2020 was 21.3% higher than in August. Although this remains 0.7% lower than September 2019 figures, growing mortgage application figures suggests there are significant property transactions yet to complete. In October 2020, Rightmove reported **the average time period to sell a house had fallen to only 50 days, the fastest recorded time ever.**

HISTORIC UK RESIDENTIAL PROPERTY TRANSACTIONS (2005 TO 2020)



CONSTRUCTION SECTOR

According to ONS data, construction output rose by 2.9% in September 2020, representing the fifth consecutive month of growth since April 2020. However, September 2020 output remains 7.3% below February levels.

Industry output is expected to fall by 14.5% in 2020 when compared to 2019, according to the Construction Products Association Autumn forecast. Whilst representing the sharpest fall on record, this is an improvement from their original forecast published in Summer 2020, in which they predicted a drop in output of 20.6%. In the long run however, there are promising signs of recovery for the industry, with output in 2021 expected to increase by 13.5%.

> Output in 2021 expected to increase by 13.5%.

M&A

The past five years has seen substantial M&A activity in real estate services, although this has slowed slightly since the outbreak of the pandemic. **Since 1 June 2020, there have been 39 deals in the UK** (to 1 December 2020), this is in contrast to **57 deals in the same six-month period to 1 December 2019.**

Recent deals have mainly been driven by two key trends: **investments in online property platforms**, with Immo and Appear Here achieving Series A and later stage VC funding respectively, and **real estate agency acquisitions** by existing firms in the market looking to consolidate their market position. In September 2020, Northwood Franchises (a subsidiary of Belivior Lettings, one the UK's leading letting agents) acquired estate agency Bowes Mitchell, with Martin & Co (a UK leading letting and estate agency) acquiring estate agents Beechfield Properties in October 2020.

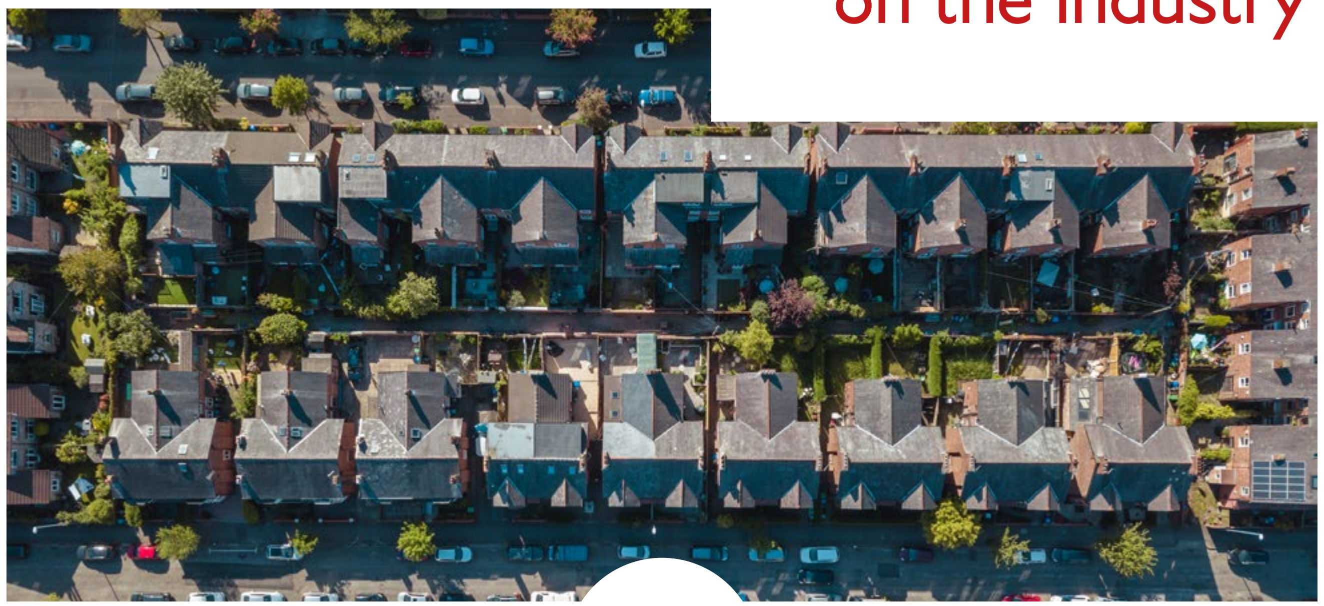
Highlights in M&A activity since 1 June 2020

Date	Company	Lead Investor	Amount
22 June	**Houst**	Various (Crowdfunding)	£2.62m
22 June	**Preston Baker**	Redbrik	Undisclosed
1 July	**Proportunity**	Anthemis Group	£1.52m
7 July	**Andrew Grant Commercial**	Centrick Property	Undisclosed
20 July	**Agent & Homes**	Podium Ventures	Undisclosed
21 July	**CapitalRise**	Government of UK	£2.21m
20 August	**Immo**	HV Holtzbrinck Ventures	£12.67m
10 September	**Bowes Mitchell**	Northwood Franchises	Undisclosed
17 September	**Appear Here**	JLL Spark	£10.67m
24 September	**OneDome**	Reuben Brothers	£5m
2 October	**Homes For Good**	Big Issue Invest	£3m
19 October	**Beechfield Properties**	Martin & Co	Undisclosed
17 November	**Giraffe360**	Hoxton Ventures	£3.44m

Conclusion

It is clear that there are large disparities in the performance of the individual sub-sectors of the property sector since the outbreak. However, it is still too early to fully assess the long-term impact of the pandemic on the industry. Analysts believe the 'true impact' will be felt across all sub-sectors once government support for both people and businesses end in March 2021, after which the industry will have to adapt to a 'new normal' of working practices and consumer preferences.

> It is still too early to fully assess the long-term impact of the pandemic on the industry



IS IT 'PANDEMIC PANIC OR A PANACEA'?

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COVID-19 has affected all of us, from how we live our life to where we will work from in the future. But what about that office space we spent years congregating in and hours commuting to every day?

The Government has recognised the need to provide office/premises owner operators with the flexibility to alter their 'redundant' premises to other uses. Here we take a look at one option brought about by the pandemic.

PERMITTED DEVELOPMENT RIGHTS

Permitted development rights (PDR) allows a building owner to perform certain types of works without the need to apply for planning permission.

PDR is granted by Parliament and not the Local Authority. However, be mindful that some 'rights' which apply to residential property have different rights for commercial property. Residential property created through PDR, i.e. shops with residential uppers, offices and agricultural premises, cannot then use householder permitted developments rights to improve, alter or extend further. Further planning permission is required.

RESTRICTIONS ON PDR

If the property falls into an area of 'designated' importance there are further restrictions in place. You will require planning permission if the property is in one of the following areas.

- **Conservation Area**
- **National Park**
- **A O N B**
- **World Heritage Sites** including places like the Norfolk/Suffolk Broads

'ARTICLE 4' DIRECTIVES

Article 4 Directives are when a Local Authority remove some of the rights of permitted development. This will require planning permission for work that is normally permissible.

The Local Authority can issue an 'Article 4' restriction when they believe a proposed development will adversely affect the character of an area. Article 4's are most common in Conservation Areas. Check with your local authority whether your building falls into this category.

PROFESSIONAL ADVICE IS CRUCIAL

There are no perceived savings in avoiding professional advice when it comes to redevelopment. Using a planning consultant in conjunction with your architect, accountant and legal advisors are essential to ensure the success of your scheme.

Your planning consultant will most likely have a solid relationship with the local authority planning department. They will have a detailed understanding of the type of development that planners will want to see and which schemes are most likely to achieve a successful outcome.

Finally, my candid opinion is that **PDR is no 'panacea' but does provide options for businesses to adapt to a 'post' COVID world that will almost certainly challenge us in ways not seen before.** The pandemic has caused us all as individuals to reappraise, adapt and change. It's no different for our businesses because if they don't change now, they risk being left behind.

> Permitted development rights (PDR) allows a building owner to perform certain types of works without the need to apply for planning permission.

IMPACT OF CIS ON PROPERTY DEVELOPERS AND INVESTORS

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Most businesses that offer construction services will be aware of the special Construction Industry Scheme (CIS) tax regime that exists.

CIS requires the business or contractor, who has engaged the services of a sub-contractor to undertake construction operations on its behalf, to report payments made to that sub-contractor to HMRC monthly via a specific online submission process.

In addition, the business or contractor will be responsible for verifying the appropriate tax rate applicable to each sub-contractor by using an HMRC online verification service before deducting any tax due from the sub-contractor and paying over to HMRC. Other requirements of the scheme include the issue of a monthly deduction statement to those sub-contractors where a CIS deduction has been made.

Failing to operate the CIS scheme correctly will undoubtedly allow HMRC to collect any underpaid taxes from the contractor and to impose severe penalties for failures, such as late or incorrect monthly returns.

PROPERTY DEVELOPER OR INVESTOR?

There are special issues for those businesses that consider themselves to be a property investor rather than a developer, so it is critical to understand how the scheme affects your business before HMRC decides to make enquiries into your CIS compliance.

A property developer will fall into the definition of a "mainstream" contractor for the purposes of the CIS legislation because the nature of its trade will be construction and, as such, will be required to operate the scheme from day one.

A property investor's CIS position is less obvious, so special care must be taken to decide whether the CIS scheme applies when your business is involved in property investment.

If a property investment company simply purchases a property to hold as an investment or for rent and arranges for the property to undergo minor refurbishment before being ready for occupation, then these activities will not be considered those of a mainstream contractor.

However, **if a property investment business spends more than £3 million over three years on construction operations, which would include refurbishments, then the business will be considered a deemed contractor** for the purposes of CIS and will be required to operate the scheme on payments it makes to its sub-contractors. The business will need to register as a contractor with HMRC as soon as it is apparent that the £3 million trigger point is reached. Failure to do so will result in failure penalties plus the potential CIS tax liabilities due from payments already made to the sub-contractors.

In particular, difficulties can arise where a business that is normally operating as an investment company takes on a property that requires significant construction work, perhaps including a change of use. In these types of contracts, HMRC will consider that the nature of the trade of the business has moved from investment to development, so care must be taken to consider the impact of CIS on each project the business undertakes.

HMRC has now published its response to a recent consultation exercise aimed at combatting perceived abuse of the CIS scheme and has made it clear that it will be looking to increase its compliance activity around CIS. This gives rise to the possibility that it will look to increase its yield in this area, given the impact of the pandemic on the economy.

If your business operates the scheme or there are questions over whether your business might be caught by the scheme and you would like to discuss the matter further, please contact us.

Note: The Guild offers compliance solutions to the engagement of sub-contractors in the Construction Industry.

> Special care must be taken to decide whether the CIS scheme applies when your business is involved in property investment.

HOW IS THE LONDON LETTINGS MARKET RESPONDING TO COVID-19?

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The lettings market continued to show strong demand through Q4 2020. With the normal cycle of the markets severely disrupted since the Covid-19 outbreak, it is hard to say what is driving the continued demand, but we believe it is a combination of several factors.

With restrictions on movement due to Covid-19 weighing heavily on peoples' minds, this seems to have spurned many people into action. We have **seen higher than usual numbers of applicants registering with us in October 2020**; typically, a month when numbers start to dip, many of them very keen to secure larger properties with the amenities they require to see them through any future lockdowns.

Young professionals are getting on with the life and their careers, tenancies in London for the under 30s working professionals remain strong . We have seen applicants from many of the big tech firms such as Facebook and Google come to us through our corporate relocation department. While Covid-19 is still very much with us, young professionals are keen to mitigate its negative influence on their careers.

With many of London's top universities conducting this year's programs virtually the **market for overseas students has seen a significant dip.** However, it is not all doom and gloom for student landlords as we have seen many first and second year domestic students fill this space. Many young people are eager to get out of their parents' homes and into the London social scene.

The short-term lettings market continues to face a strong headwind with reduced applicant enquires and the lack of overseas tourists who make up a large part of the summer market for short lets in London. The increased availability of stock also continues to put downward pressure on prices in the sector. Landlords can take some comfort as many domestic applicants who are in a period of flux and uncertainty are opting for a short let until they have a clearer picture of what 2021 will look like for their home and work lives.

Tenancies in London for the under 30s working professionals remain strong

RESTRICTIONS ON WINDING UP PETITIONS

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On 26 June 2020, The Corporate Insolvency and Governance Act 2020 became law, which brought temporary measures to protect businesses through the pandemic, such as the restrictions on winding up petitions.

The restrictions on winding up petitions protect companies from creditors where unpaid debt is a result of Covid-19. The measure includes provisions to void statutory demands issued against companies during the pandemic to give businesses the opportunity to reach fair agreements with creditors.

The restrictions on winding up petitions was due to end on 30 September 2020, then extended to 31 December 2020, but has now been further extended to 31 March 2021 to give businesses more 'breathing space'.

> The restrictions on winding up petitions has now been extended to 31 March 2021

The government has also confirmed:

- **It intends to reinstate** the temporary removal of the threat of personal liability for wrongful trading from directors until 30 April 2021
- **Companies and other qualifying bodies** with obligations to hold AGMs will continue to have the flexibility to hold these meetings virtually until 31 March 2021

However, at some point the handcuffs will be removed from landlords, and since there can be no guarantee that this will happen in a graduated way, all tenants will need to have a plan in place for when that happens.

Ludgrove Property

LONDON PROPERTY MARKET UPDATE AND OUTLOOK

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Mainstream London

The mainstream London property market has recovered strongly from the lows with prices growing +4.4% y.o.y to the end of Q3 2020. Much of this has been driven by pent-up demand and the rush to beat the Stamp Duty holiday deadline of 31 March 2021. Behavioural shifts have also played a part with **heightened demand for larger properties and outside space** leading to a disproportionately higher level of transactions amongst houses versus flats. The apartment market (where first-time buyers with low deposits are significant players) has also suffered from a reduction in risk appetite amongst banks, with the vast majority of banks withdrawing or significantly curtailing high LTV mortgages.

Looking forward into 2021, we expect the first quarter to be dominated by the continued rush to beat the stamp duty deadline whilst the roll-out of the vaccine is likely to gradually bolster consumer confidence and economic growth. On the assumption that the stamp duty holiday does come to an end on 31 March 2021, we would expect transactions to fall markedly in Q2 before picking up again in H2 as economic growth and consumer confidence gains a firmer footing.

Prime London

In the Prime Central London (PCL) property market, activity in 2020 has been more muted with prices down -1% y.o.y to September 2020. **The Golden Postcode areas of Mayfair, Belgravia, Knightsbridge and Chelsea in particular have suffered from a lack of international travel and overseas Buyers.**

Purchases here also tend to be more discretionary in nature and the economic uncertainty has encouraged many buyers to simply sit on the side lines.

Overall, the market for PCL houses has outperformed apartments. For instance, achieved prices for houses in St John's Wood, Regents Park and Hampstead are up +16% y.o.y, whereas flats in the same area have fallen by -3% y.o.y. In Putney Barnes & Wimbledon, house prices are up +5% whereas flats are down -2% y.o.y.

Ludgrove remains sanguine on the outlook for Prime Central London and we believe the market is fundamentally cheap as outlined in our recent newsletter. Some of the reasons for our optimism are:

- **The downturn is long in the tooth** with prices having fallen for 75 months, making this the longest PCL downturn on record.
- **The real terms fall in prices** (-30% from peak in 2014) is very similar to where prices have troughed and rebounded in the 1989-92 and 2009/09 recessions.
- **In real terms, prices have returned to Q2 2007 levels.** In other words, 13 years of growth has been wiped-off the PCL market in recent years.
- **In a world of QE driven**, asset-price inflation, **PCL prices** have lagged significantly.
- **PCL tends to be early-cycle** with its best returns usually seen early in the economic cycle.

VAT AND THE DEFINITION OF A GUARDIAN

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A very useful VAT relief can be applied when carrying out renovations to eligible dwellings. A builder will normally charge VAT at the reduced rate of 5% if the dwelling hasn't been lived in during the two years immediately before work starts. This is covered in the VATA 1994 Schedule 7A Group 7 items 1 and 2.

The relief is quite wide ranging, a builder can reduce rate any works of repair, maintenance or improvement carried out to the fabric of the building. They can also reduce rate the installation of goods that are building materials but not the installation of goods that are not building materials, such as carpets or fitted bedroom furniture.

One of the key conditions is that the dwelling must normally be empty for two years immediately before works begin. HMRC consider that some occupation is not considered relevant and can be ignored, including the occupation of the building by guardians or squatters.

VAT AND THE DEFINITION OF A GUARDIAN IN ACTION

We recently had a very interesting case regarding HMRC's interpretation of the scope of the term 'guardian'. We were approached by a client who had bought a house in the country which required a complete refurbishment. They lived in London and so whilst they were considering their options with regards to the works required, they rented the house to the previous owner. He had lived there for twenty years and was happy to stay there on a shorthold tenancy, paying £250 per annum in rent.

The house was quite dilapidated and could not have been rented on commercial terms. **The client wished to take advantage of the reduced rate rules but was concerned that HMRC would not consider the house to have been empty over these two years** due to the tenant living there. We advised that a non-statutory clearance application to HMRC would be the best course of action in order to obtain certainty on the correct VAT liability of the works.

The result was **that HMRC agreed with our argument that the tenant was living in a very dilapidated house and was mainly providing security** and acting as a deterrent to squatters. An odd result as the person living there after the sale was living there before, but after the sale of his house the nature of his occupation, at least in the world of VAT, changed.

This gave our client the go-ahead to embark on the renovation works at the reduced rate and we think that this clearance extends the definition of the term 'guardian' which may be useful to others in a similar position.

> Properties that have been empty for at least two years will be eligible for a reduced VAT rate of 5%.

TAX NOTES FOR NON-RESIDENTS

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In the last publication we discussed the Stamp Duty Land Tax (SDLT) increases for non-residents and the changes in the taxation and declaration of gains arising from the disposal of UK property and land by non-resident companies.

In this publication, we cover a brief summary on offshore trusts owning UK property and land. But, before we do, there is more news on the beneficial ownership requirements for overseas owners:

OVERSEAS OWNERS OF LAND IN THE UK – NEW REQUIREMENTS

The government intends to introduce a register of beneficial owners of overseas entities which own land in the UK, effective from 2021. This means that overseas entities which own land in the UK, or wish to acquire land, will need to register at Companies House and failure to do so will mean that such entities will not acquire land legal title.

Transparency remains the key driver for the government to introduce the register, whilst at the same time increasing consistency between the requirements placed on UK companies and those imposed on overseas entities.

"Overseas entity" is broadly defined to include foreign companies, partnerships and other legal entities, which are legal persons governed by the law of a country or territory outside the UK. Concerns over the fact that offshore trusts could be used to circumvent the requirements were addressed and it was felt that the expansion of the UK's Trust Registration Service under the Fifth Money Laundering Directive would sufficiently meet the disclosure requirements.

These developments are significant for overseas clients holding or acquiring property in the UK.

> Overseas entities which own land in the UK, or wish to acquire land, will need to register at Companies House

OFFSHORE TRUSTS AND UK PROPERTY OWNERSHIP

The tax benefits of owning UK property via offshore trusts may have been eroded but they still remain useful vehicles for succession planning, management, control and protection of assets.

Recent changes to the treatment of UK residential property held by offshore trusts mean that **many offshore trusts that were not exposed to UK IHT will now fall within the UK IHT regime.** This regime has been effective since 6 April 2017. Prior to this date, it was common for non-UK domiciled settlors to hold UK residential property through an offshore company and trust structure and not be subject to UK IHT.

The rules have changed so that IHT does now apply to trusts holding UK residential property directly or indirectly, in the form of entry charges, 10-year anniversary charges and exit charges on outright distributions to beneficiaries. Additionally, depending on the values, there may be reporting requirements even if there is no IHT to pay.

The rules have also changed in relation to loans made to allow trusts beneficiaries to purchase, maintain or improve UK residential property which may bring the benefit of such loans within the UK IHT net. Furthermore, loans to UK resident beneficiaries are UK situs assets for the purposes of UK IHT.

Offshore trustees therefore need to be aware of the complexities involved in determining the UK IHT obligations and ensuring the required reporting has been done.

Furthermore, the UK is expanding its requirement for trusts to register under its Trust Registration Service (TRS) as a result of the transposition in the UK law of the EU's Fifth Money Laundering Directive (5MLD). Up Until recently, the requirement to register had been limited to trusts who have an imminent UK tax liability only. However, with effect from 10 March 2020, it was proposed that newly created trusts will need to register within 30 days of creation, irrespective of whether or not they have a UK tax liability. Additionally, all trusts currently not registered under the TRS will need to register by 10 March 2022, again regardless of whether or not they need to pay UK tax.

The government has now issued the final regulations which were laid before Parliament on 15 September and has taken effect from 6 October. These regulations clarify some of the uncertainties raised by the previous draft regulations.

The most significant uncertainty was whether a non-UK trust, which has no UK tax liabilities would be required to appear on the UK Trust Register simply because it engages a UK services provider (such as a lawyer, accountant, banker, investment manager etc.) The regulations confirm that this will not be the case and 5MLD only requires a trust to be registered if it has some other connection with the UK for example a UK resident trustee.

The good news is that although there will still be a large number of trusts which will be required to register for the first time, the scope of the exemptions have been significantly expanded. How that fits with the register of beneficial owners of land in the UK is yet to be seen.

Watch this space!

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