BUILT ENVIRONMENT

insights

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Welcome

We are delighted to introduce our fifth issue of Built Environment Insights, our biannual publication in which we cover key topical issues for the Built Environment industry. In this edition we explore the major shifts in UK tax policy and rules and what this means for new and existing structures for overseas investors, in Australia we explore the increased demand of short-stay letting and how statutory regulation is catching up and how the UK's Built Environment industry is responding to the impact of climate change in 2019.

We hope you find this edition useful and informative. If you would like to discuss any of the topics and issues raised in this edition, please contact your usual Ashurst contact or the authors of the articles.

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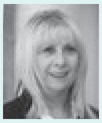

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OVERVIEW


UK


UK


GLOBAL

Resilient buildings

Adapting to the changing climate

By Jacqui O'Keeffe and Joanna Fox

As the Built Environment sector is particularly vulnerable to climate change risk, it is likely to feature in the adaptation and mitigation measures adopted globally by the parties to the Paris Agreement, as well as the financial instruments that will underpin the unprecedented action required. We take a look at how the UK's response is shaping up to the potential impacts.

RESILIENT BUILDINGS AND CLIMATE CHANGE

In this article we look at how the likely impact of climate change and related policy changes may impact the Built Environment sector. It is anticipated that such impacts will increase both in frequency and intensity as a result of changes such as temperature and flooding. Climate change risk is already attracting considerable interest from mortgage and insurance markets. It is also likely that this issue will increasingly impact investment decisions and the value of real estate portfolios.

ADAPTING TO CHANGE

Amid the political turmoil of 2018, several reports were published warning of the impact of our changing climate, one of the greatest challenges we face. At the United Nation's Climate Change Conference in December, Sir David Attenborough warned "If we don't take action the collapse of our civilisations and the extinction of much of the natural world is on the horizon". Guidelines were agreed at the Conference to implement the historic 2015 Paris Agreement, which pledged to keep the global average temperature rise below 2 degrees

Celsius compared to pre-industrial levels, and to drive efforts to limit the increase to 1.5 degrees Celsius.

The message is clear: immediate action is required, and the window in which action to avoid the predicted devastating consequences of the global average rise in temperature is closing rapidly. As the Built Environment sector is particularly vulnerable to climate change risk, it is likely to feature prominently in both the adaptation and mitigation measures adopted globally by the parties to the Paris Agreement and the financial instruments that will underpin the unprecedented action required. In this article we take a look at how the UK's response is shaping up.

GLOBAL CHANGE

It is estimated that 571 European cities will be affected by droughts, heat-waves and floods more severely than previously thought. The Built Environment contributes to this accounting for an estimated 40% of global energy use, an estimated 30% of energy-related greenhouse gas emissions and a large share of waste generation and use of natural resources. The report published by the Intergovernmental Panel on Climate Change in October 2018 considered the impact of global warming of 1.5 degrees Celsius and the mitigation and adaption measures that will need to be taken to limit warming to this level. Electrification, energy efficiency and renewable energy are examples of the adaptation and mitigation measures required to reduce energy usage and decarbonise energy supply in the Built Environment sector to meet the goals set out in the Paris Agreement. The report also recommends additional changes needed in urban areas, including the "demotorisation" and "decarbonisation" of transport through the expansion of electric

vehicles and greater use of energy-efficient appliances.

UK ADAPTATION PLANS

The UK's second National Adaptation Programme (the UK NAP) published in July sets out how the Government intends to deal with the most urgent risks from climate change over the next five years, which may include increased instances of flooding; public health risks from increased temperatures; damage to natural ecosystems and biodiversity; disruption to domestic food production and trade; impacts on water and energy supplies; and new and emerging pests, diseases and invasions by non-native species. Resilient buildings represent one aspect of the programme; air quality and transportation issues and energy policy also feature. The UK NAP sets out a number of objectives and actions aligned with these risks. In respect of flooding, objectives include making sure that decisions on land use, including development, reflect the level of current and future flood risk, and boosting the long-term resilience of homes, businesses and infrastructure. In respect of increased temperatures, the UK NAP sets out actions that will be taken to deliver more, better quality and well-maintained local green infrastructure, to adapt health systems, and work with infrastructure operators to outline risks posed to their productivity. The Government has stated that these steps, and more, will be taken over the next five years to strengthen the UK's resilience to climate change.

We may start to see these international and national commitments filtering through into real estate transactions.

RICS GUIDANCE

In October, the Royal Institute of Chartered Surveyors (RICS) published a new guidance note on environmental risks and global real estate, which considers the implications for how real estate is bought, sold, used and valued. The guidance acknowledges that part of the reason for the extensive growth in environmental law is an increasing awareness of how climate change is impacting the economy, including the Built Environment sector: "Global market participants and their lending partners now demand to know more about the factors that could affect value, particularly environmental considerations". The guidance sets out good practice for RICS members and firms that are regulated by RICS. RICS guidance can be persuasive in legal proceedings, and case

law has established that it can be determinative of constructive knowledge about identified risks and recommended mitigation measures.

COMMITTEE ON CLIMATE CHANGE

The UK's Committee on Climate Change (CCC) is an independent, statutory body established under the Climate Change Act 2008 which reports to Parliament on the UK's progress with reducing greenhouse gas emissions and preparing for climate change. The CCC is committed to publishing progress reports, and the most recent report, published in June, identifies that, although the UK is making progress in some areas, emissions from buildings actually increased in 2017 on a temperature-adjusted basis. However, the CCC considers that there is considerable scope to reduce emissions by improving resource efficiency during the construction of buildings and infrastructure. New and existing buildings are estimated to account for around one-third of the UK's greenhouse gas emissions and the Prime Minister pledged in May 2018 to halve energy usage of new buildings by 2030. To meet these targets, the UK Government is looking at cost-efficient ways to make all sectors of the economy more climate-friendly and less energy-consuming. The CCC is also calling for tougher long-term standards for construction emissions, while driving consumer demand, innovation and cost reduction. These standards may require retrofitting measures.

NEW REPORTING REQUIREMENTS

The Government considers that measuring and reporting energy use and emissions can help to drive improvements in energy efficiency and financial savings

for organisations. A statutory instrument will come into force on 1 April 2019 introducing new reporting requirements for large unquoted companies and limited liability partnerships to annually report on emissions, energy consumption and energy efficiency action.

SUSTAINABLE CONSTRUCTION MATERIALS

There is also increasing recognition of the importance of materials and construction methods in real estate assets to meet decarbonisation goals and develop sustainable, resilient buildings.

The Government considers that new methods in construction may help with the construction of new energy efficient homes more quickly and cheaply. HM Treasury and the Infrastructure and Projects Authority have recently launched a consultation on how prepared the construction industry is to adapt to a new approach to building, and the Government is currently tendering a £1.4 million three-year research project to address the drivers, barriers and challenges of new low-carbon homes.

FLOOD AND TEMPERATURE RISK: PLANNING, POLICY AND INSURANCE

One of the objectives of the National Planning Policy Framework (NPPF) includes the protection and enhancement of the built environment through adapting to climate change. The NPPF aims to achieve this by improving the resilience of buildings, for example by taking account of flood risk and the risk of overheating. Loss and damage caused by flooding results in billions of pounds worth of damage to businesses and households each year. The effects can include direct and indirect physical damage to building structure, resulting in business interruption and disruption to supplies and services.

In the 2018 Budget, the Chancellor announced a £13 million fund to tackle risks from floods and climate change. An increased risk of flooding, sink holes and subsidence will impact on the ability to obtain mortgages, and insurance premiums may increase in response to climate change pressures.

Although investors and developers generally rely on insurance to protect against flood risk, given the increased susceptibility of buildings to flooding and foreseeability of the risk, the ability to insure real estate interests against such risks is not guaranteed. Insurability concerns may also adversely impact on the

ability to secure financing.

Increasing the resilience of buildings to rising temperatures is also a significant challenge. The Environment Audit Committee (EAC) considers that, at current temperatures, one in five homes in the UK overheat. As a result, buildings often rely on air conditioning units, which add to both air pollution and greenhouse gas emissions and increase energy consumption. The Government has recently acknowledged that since 2015 it has been aware that all new builds are prone to overheating. The NPPF considers that the risk of overheating should be examined, but there are currently no building regulations in place to prevent overheating.

Members of Parliament are particularly concerned about the effects of overheating on real estate assets such as hospitals and care homes, and the CCC and the EAC are pushing for policy changes. The EAC argues that, if building regulations do not change, there is a risk costly remedial works will be required as heatwave risk intensifies. The Government has stated that new homes will be built in a way that minimises overheating, but does not consider overheating in the wider built environment.

This is likely to be a key policy issue and we may see building regulations which require potential overheating to be mitigated. The effects of overheating can be mitigated by construction materials, considering ventilation and shading, and investing in new technologies to reduce interior temperatures and the consequential need for air conditioning.

IMPROVING THE RESILIENCE OF THE BUILT ENVIRONMENT SECTOR

In the 2018 Budget, the Chancellor announced that a new study on improving the resilience of UK infrastructure "in light of technological advances and future challenges such as climate change" will be published in spring 2020 by the National Infrastructure Commission. This report will look at how resilience can be assessed and improved, including through better design and the application of new technologies. In the meantime, investors and developers should consider the risk of investing in real estate assets that may require urgent adaptation at a considerable cost, as well as the potential benefits of investing in sustainable and resilient buildings.

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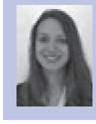

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Restricting short-stay letting in residential developments

Not as easy as you might think

by Jason Cornwall-Jones

The global popularity of private short-stay letting as an alternative to booking hotel rooms has increased significantly in recent times.

Online platforms such as AirBnB and Stayz dominate the short-stay market. The accessibility of short-stay letting may be a welcome development in many circumstances. For example, short-stay probably has a role in smaller holiday locations with insufficient hotel accommodation, or heritage areas which are not suitable for hotel development. However, short-stay in CBD residential apartment blocks can be more problematic. Private apartments being used as a surrogate for "regular" hotel rooms creates an unfair playing field for hotels, as hotel businesses tend to pay more by way of taxes, OH&S compliance, insurance and other overheads. Owner-occupiers and long-term tenants of apartments and residential units also often object to having an ever-changing array of temporary neighbours.

Statutory regulation of short-stay letting is in its infancy in many cities, and hasn't really caught up with short-stay. Principles relating to the inviolability of private property continue to run strong – if someone wants to let their house for the weekend, why shouldn't they?

Perhaps because the principle of a "person's home being their castle" developed in an age before 50 story apartment blocks, all-night parties and heavy duty sub-woofers.

In the absence of adequate statutory regulation of short-stay letting in Melbourne, Australia, Ashurst was recently instructed by developer Capital Alliance Investment Group to devise a creative solution using existing legal principles to cover the shortcomings in the existing statutory regime – more on this later.

THE PROBLEM OF SHORT-STAY LETTING IN APARTMENT BUILDINGS

An increasing number of residences are available for short-stay letting in many cities. In Melbourne, Australia, according to independent data tool Inside AirBnB, 14,379 entire apartments/homes and 8,116 private rooms were listed as available for short-stay in 2018.

Apartment owner-occupiers and long-term tenants have voiced concerns in respect of short-stay letting in their buildings. These concerns include fears for safety and security, as well as apprehensions of damage to common property (pools and gyms) and interference with amenity. Mohan Du, Founder and Chief Executive of Ashurst client Capital Alliance Investment Group, commented that *"having unsanctioned 'quasi-hotels' operating out of residential developments is unsafe and undesirable because the buildings are not designed for it and it exposes long-term residents to unruly behaviour one would not expect in and around their homes".*

In one central Melbourne apartment building, the damage to communal areas caused by short-stay tenants became significant enough to warrant the installation of fingerprint locks in communal areas. Newspapers in Melbourne have reported residents complaining of mess, theft, loud parties, damage to common property and other disruption. Such incidences are not restricted to Australia. An English newspaper labelled short-stay apartments in one Central London apartment block as "pop-up brothels" – with apartments being rented on a daily basis by local sex-workers. There were also reports of drug-use and loitering. The extent to which these problems are attributable solely to short-stay letting is hard to say. Nevertheless, it is clear that short-stay letting in these circumstances is not helpful.

TRADITIONAL SOLUTIONS TO SHORT-STAY LETTING IN APARTMENT BUILDINGS

The "traditional" solution for restricting short-stay letting in apartment buildings has been to include restrictions in the owners corporation rules prohibiting short-stay letting. However, recent Australian case law has called into question the enforceability of such rules.

In *Owners Corp PS 501391P v Balcombe*[1], the Supreme Court of Victoria held that the Owners Corporation could not prohibit short-stay letting. The rule passed by the Owners Corporation by special resolution, was held to be outside the scope of the relevant legislation.[2] Similarly, the NSW Civil and Administrative Tribunal (NCAT) in *Estens v Owners Corp SP 11825* held that a by-law passed by the Owners Corporation, designed to exclude short-stay letting, was invalid.[3] NCAT held that short-stay letting via AirBnB is a *devolution* of a lot by way of a lease. As a result, the rule was invalid for being inconsistent with the applicable law.[4]

On the other hand, in *Byrne v Owners of Ceresa River Apartments Strata Plan 55597* [5], the Western Australia Supreme Court held that the Owners Corporation could reasonably restrict use by way of by-laws because that was consistent with the relevant statute.[6] The United Kingdom Privy Council adopted the same approach in *O'Connor (Senior) and others v The Proprietors, Strata Plan No. 51*.[7] The case was concerned with by-laws in the Turks and Caicos Islands. The Privy Council held that the relevant legislation did not prevent *reasonable* restrictions on use being made. Interestingly, the legislation under consideration in *O'Connor* was modelled on the NSW strata legislation.

LESS TRADITIONAL APPROACHES

Taking into account the problems with enforcing short-stay restrictions in owners corporations rules, Capital Alliance recently asked Ashurst to consider a more effective restriction for their Docklands and Southbank Developments in Melbourne.

The solution that we designed essentially involved using a traditional legal concept (a restrictive covenant) in a novel way. In particular, we included in the plan of subdivision a restrictive covenant preventing short-stay letting in favour of the owners corporation on the title to each unit in development. The restrictive covenant runs with the land, is apparent from a search of the title, and is relatively easy to put in place – it is a simple addition to the plan of subdivision. For good measure, we also included a contractual restriction in the contract for sale, and we included a prohibition in the owners corporation rules (despite current questions about the enforceability of prohibitions in the owners corporation rules, the law is moving swiftly in this space). Any concerns that such measure might impact the

1. [2016] VSC 384.
2. Subdivision Act 1988 (Vic); Owners Corporation Act 2006 (Vic).
3. [2017] NSWCATCD 63 (6 July 2017).
4. Strata Schemes Management Act 2015 (NSW) s 139(2).
5. (2017) 51 WAR 304.
6. That is, the Strata Titles Act 1985 (WA).
7. [2017] UKPC 45 (21 December 2017).
8. Owners Corporations Amendment (Short-stay Accommodation) Act 2018 (Vic).

marketability of the apartments have been unfounded – in fact, quite the opposite. Mohan Du notes that these restrictions have received positive responses from buyers: *"what we had not expected was the level of support and commendation from owner-occupiers who noted that short-stay accommodation next door to their principal place of residence was one of their number one concerns"*.

NOW THE LAW NEEDS TO CATCH-UP

The device described above is appropriate for new developments, but would not be suitable for existing buildings. This means the law need to catch-up and fill the gap.

Australian legislatures now appear to be alive to the issue and are better regulating short-stay letting. In the last year, the Victorian Government passed laws regulating short-stay letting.[8] Upon the occurrence of certain conduct, in buildings managed by owners corporations, applications may be made to the Victorian Civil and Administrative Tribunal (**VCAT**). The relevant conduct includes that which causes excessive noise, hazards, interference with the use of common property, or damage to common property or a lot. VCAT may make a prohibition order, compensation order, or an order for a civil penalty. The applicant has the burden of providing evidence of the conduct and the harm it caused.

The Victorian framework does not enable owners corporations to prohibit or restrict short-stay letting. Rather, action must be taken in VCAT each time specified conduct occurs. This may not be practical – particularly where there are large volumes of short-stay letting arrangements in a building.

The NSW Government has also recently passed to two key pieces of legislation, which have not yet commenced. The legislation authorises the declaration of a Code of Conduct. The Code of Conduct will establish a complaints system, appoint independent adjudicators and create an exclusion register. The Code will entail a "2 strikes and you're out" policy. Additionally, the legislation empowers owners corporations to pass by-laws to prohibit short-term letting upon a 75 per cent majority vote – but only in lots that are not the principal place of residence of the host.

Changes to the NSW planning laws have also been proposed. The amendment would restrict short-stay letting in Greater Sydney to 180 days per year, where the host is not present. Short-stay letting in all other areas of NSW would not be restricted, unless the governing Council restricted it (to no less than 180 days per year).

The proposed NSW planning law amendment aligns with the approach taken in England. Short-term renting in London is permitted for up to 90 nights in a calendar year. However, we understand these restrictions have been difficult to enforce. Many owner-occupiers have complained of illegal arrangements in contravention of the planning laws. It seems that such restrictions are ineffective at managing arrangements in inner city apartments.

Developing a regime which strikes a balance between respecting a person's right to deal with their property, but also protects the legitimate interests of neighbours to avoid the problems associated with short-stay letting, is clearly not easy. We suggest the recent changes in Victoria and NSW should be closely monitored to see what works, and what does not work.


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Detoxifying the planning process

Revoking hazardous substances consents

by Charlie Reid

When redeveloping former hazardous installations the need to remediate the land itself is apparent but what is often overlooked is the need to clean-up the consenting position. Sites that once housed hazardous substances will have needed hazardous substances consents ("**HSCs**") and these can remain a barrier to development even if they are in effect redundant. This article considers the practicalities of revoking HSCs within the context of the planning system's drive to increase housing supply.

BACKGROUND

The hazardous substances regime ensures that necessary measures are taken to prevent major accidents and limit their consequences to people and the environment. The regime originates from a number of major incidents in Europe in the 1970s, the most significant of which took place in Seveso, Italy, in 1976, where the accidental production and release of a dioxin as an unwanted by-product from a runaway chemical reaction led to widespread contamination. Such incidents, and an acknowledgement of the need to reconcile different standards of control over industrial activities within the EU, led the European Commission to propose a Directive on the control of major industrial accident hazards. The original Seveso Directive was adopted in 1982; it has been amended over time and the current iteration, Seveso III, was adopted in 2012.

The objectives of the Directive are achieved through two main areas: (1) land use planning requirements and (2) health and safety measures. In England, the former is implemented through the Planning (Hazardous

Substances) Act 1990 and the Planning (Hazardous Substances) Regulations 2015 and the latter is delivered principally through the Control of Major Hazards Regulations 2015 ("**COMAH**"). This article focuses only on the land use planning aspects in England.

The process established by the Planning (Hazardous Substances) Act 1990 (the "**Act**") regulates the storage and use of hazardous substances by making a HSC a prerequisite to storing hazardous substances on sites in controlled quantities. HSCs therefore provide control over the presence of hazardous substances whether or not an associated planning permission is required for the development of a hazardous installation. The authority responsible for granting HSCs, the Hazardous Substances Authority, is usually the relevant local council and often this is the same entity as the Local Planning Authority. Where this is the case, it needs to be remembered that the authority's planning and hazardous substances functions are related but separate.

WHY IS THIS RELEVANT?

When a HSC application is considered, an assessment is made as to risks and likely effects of major accidents occurring at the installation. The decision as to whether the level of risk is tolerable for the surrounding community and environment is made by the Hazardous Substances Authority. However, the HSE[1], as the COMAH competent authority and statutory consultee on HSC applications, will advise the Hazardous Substances Authority as to the nature and severity of risk. The HSE sets a consultation distance ("**CD**") around major hazard sites following the risk assessment, being the area which the HSE considers at risk from either the activities being carried out or from the substances present on the site. A CD is divided into three zones (inner, middle and outer) which define the levels of likely risk or harm to individuals (including businesses) within each zone with risks and consequences decreasing from inner to outer zones.

When a HSC is granted, the CD associated with it is also fixed. This then interfaces with the land-use planning regime both at plan-making and decision-taking levels. Local Planning Authorities should know the location of hazardous installations as they will have been notified of any relevant CDs by the COMAH competent authority. When taking public safety into account in planning decisions and formulating local plans, the Local Planning Authority will need to take account of the total number of people that will be present in the CDs as a result of development coming forward.

So, for example, if a planning application is submitted which falls within a CD (for the redevelopment of the major hazard site itself or within its vicinity) the Local Planning Authority must consult with the HSE and take its advice into account when determining the application. The HSE will present its advice in one of two ways; it will either "advise against" or "not advise against" the grant of planning permission, taking into account the nature, size and characteristics of the proposed development and its location within the CD and proximity to the hazardous installation. Although the HSE's role is advisory only, it is unusual for Local Planning Authorities to go against HSE advice; where they do, the HSE has the power to request that the Secretary of State ("SoS") calls in the planning application. The HSE will also advise the Local Planning Authority on conditions which may be imposed on any planning permission.

WHY IS IT AN ISSUE?

Although the restrictions on developing around hazardous installations are understandable and necessary, the potential for conflict between the existence of an HSC and a local authority's planning priorities is clear. The housing crisis currently facing the UK exacerbates this problem. In the drive to increase land supply for new homes, the spotlight is increasingly falling on brownfield and former industrial land in our cities; even sites that once housed hazardous installations now provide opportunities for residential, employment and community uses to be developed. Indeed, the Government's Housing White Paper (February 2017) and subsequent NPPF (Feb 2019), alongside the Mayor of London's Housing Strategy (May 2018) and emerging draft London Plan, all seek to encourage the productive re-use of brownfield land; so much so that the NPPF now requires planning policies and decisions to "*give substantial weight to the value of using suitable brownfield land within settlements for homes and other identified needs*" [2].

While the policy paper trail is clear to see, it won't by itself override the paper trail left over from a site's industrial past. The problem is particularly acute where a HSC legally subsists but is redundant in practice (disused urban gas holder sites where natural gas is no longer stored in controlled quantities are a good example). This is because until an HSC is formally revoked, the CDs remain in place and are likely

1. The COMAH competent authority for most cases is the Health and Safety Executive and Environment Agency, acting jointly and for nuclear sites the Office of Nuclear Regulation and the Environment Agency, acting jointly.
2. NPPF 2018 paragraph 118(c)

to still apply. This can lead to an out of date "paper trail" that acts as a barrier to development, a political lever and commercial bargaining chip even when the absence of hazardous substances and benefits of redevelopment are plain to see. The following problems can arise:

1. An unrevoked HSC may contribute to a site not being released from an industrial planning policy designation and/or not allocated for housing and other development. This can result in substantial cost and delay for developers who may have to wait for a local plan review to lobby for a change in policy or, alternatively, prepare and consult on a planning brief, masterplan or similar to win support from the Local Planning Authority. It can also results in planning applications for redevelopment being advertised as departures from the local plan which increases call-in risk and is another hook for objectors.

   This issue could also become increasingly tactical given the direction that planning policy is taking. Policy H5 of Sadiq Khan's draft London Plan makes plain that the Mayor expects residential proposals on industrial land to deliver at least 50 per cent affordable housing where the scheme would result in a net loss of industrial capacity. A situation where a local authority supports redevelopment in principal but tactically seeks to retain an industrial allocation in order to secure greater upfront affordable housing and/or more stringent reviews of financial viability is not unforeseeable.
2. The HSE "advises against" the grant of planning permission even where the Local Planning Authority is supportive. This is a fairly regular occurrence on the basis that unless the relevant HSC is revoked, hazardous substances could in theory be reintroduced to the site. The solution is usually the imposition of a planning condition restricting occupation of the whole or part of the development unless and until the HSC concerned is formally revoked. This can be a pragmatic approach to securing the grant of planning permission, especially in circumstances where the developer has a contractual relationship with the HSC holder. However, it can store up problems where the HSC holder is a third party or adjoining landowner. In either case, it still requires the revocation of the HSC for the development to be de-risked and resource and effort on the developer's part to achieve this.
3. The more extreme outcome is a request by the HSE for the SoS to call-in a planning application following the Local Planning Authority's resolution to grant planning permission. Although not a frequent occurrence,

the situation is not unheard of. This precise situation arose at the former Ram Brewery in Wandsworth Town Centre in 2010, where the density of part of the proposed development (two residential towers) within the inner and middle zones of the CD of a neighbouring gasholder resulted in the calling-in and subsequent refusal of the application by the SoS notwithstanding a resolution to grant planning permission being made by the local planning authority. One of the reasons for refusal was the possibility of a major explosion at the gasholder; although the risk of a major explosion was considered low it was not insignificant. A revised scheme with recalibrated bulk and massing was subsequently granted planning permission at a local level but was subject to a condition preventing occupation of various blocks until the relevant HSC had been fully revoked. The condition was imposed notwithstanding written assurances from the HSC holder that it intended to decommission the gasholder and relinquish the HSC in the near future.

4. As the Ram Brewery example demonstrates, out of date HSC's can restrict development both on site and more widely. This can lead to a concentration of power in hands of HSC holder who can frustrate the ambitions of neighbouring landowners and developers as well as Local Planning Authorities.
5. Often the HSC is simply forgotten or assumed to be irrelevant. This can result in sites not being properly assessed in Environmental Impact Assessments, the HSE not being properly engaged at the pre-application stage and restrictive conditions subsequently coming as a surprise and development programmes overlooking the time and steps required to revoke an HSC. In a worst case, it can also result in missed contractual opportunities.

WHAT CAN BE DONE?

The Government's guidance acknowledges the risk that redundant HSCs pose to development:

"*Hazardous substances authorities should be proactive about revoking consents that are no longer required. Operators are required to inform the COMAH competent authority in advance of permanently closing or decommissioning a COMAH site. The competent authority will then notify the hazardous substances authority to allow for the revocation of the hazardous substances consent.*"

However, in reality, there is little evidence of this proactivity, even where a site is de-notified under COMAH. Although revocation powers sit with the Hazardous Substances Authority it will often not invoke them without first receiving a request to do so from the HSC holder.

This can be addressed where a developer is proposing to develop the hazardous installation itself by dealing with it contractually to oblige the holder of the HSC to revoke it.

The issue is less straightforward where the HSC benefits third party land. Where a deal cannot be struck with the HSC holder it may be necessary to see if the Hazardous Substances Authority can apply leverage. Where this is not possible a design scheme design may need to be explored which minimises the impact of any potential occupation restrictions that could be imposed.

HOW DO YOU REVOKE A HSC?

In simple terms the Hazardous Substances Authority makes a revocation order and the Secretary of State confirms it, following procedures similar to those used to stop up highways.

The powers for Hazardous Substances Authorities to "make" revocation orders are contained in sections 14(1) and 14(2) of the Act:

1. section 14(1) contains a general power and permits a revocation order to be made if the Hazardous Substances Authority considers it expedient to do so having regard to material considerations; and
2. section 14(2), enables a Hazardous Substances Authority to make a revocation order if it appears to them that a prescribed scenario has arisen, namely:
   - there has been a material change of use of land to which the HSC relates;
   - planning permission has been granted for development which would involve a material change of use of the land affected by the HSC and the development to which the permission or development consent related has been commenced; or
   - the hazardous substance (or substances) consented has not been present on, over or under the land to which the HSC relates for at least five years.

Section 14(4) requires that a revocation order must specify the grounds on which it is made.

Section 15 of the Act then provides that a revocation order shall not take effect unless it is confirmed by the Secretary of State. The confirmation process is handled by National Planning Casework Unit ("**NPCU**") in Birmingham on behalf of the Secretary of State.

The Act provides very little detail as to the procedural requirements for making and confirming a revocation order. In truth, the process is not complicated and the key steps can be summarised as follows:

1. The Hazardous Substances Authority "makes" the revocation order, which means that they seal and date the relevant document.
2. The authority sends the made order to the SoS for confirmation and simultaneously serves notice on landowners (and people in control of the land) and affected parties (this is a very limited list and does not comprise the general public and neighbours or other consultees). The notice should advise recipients to direct objections to the NPCU. The NCPU recommends avoiding any wider consultation as it is not strictly required and can cause confusion and delay as an authority will need to respond to any representations it receives.
3. The people on whom notice is served then have 28 days to serve objections on the SoS at the NPCU.

4. If there are objections, a local inquiry would need to be held but in practice, there would probably be some time to try and negotiate away the objections.
5. After expiry of the 28 day period, if no objections are made, the SoS can confirm the order with or without modifications.
6. Confirmation of the order involves a physical endorsement by the SoS on the order (i.e. a stamp is applied verifying that the order has been confirmed and the date plus any modifications required).
7. The order and any modifications take effect on the date of confirmation.
8. The authority then serves a second notice enclosing a copy of the confirmed order on the same parties originally served.

WHAT DO YOU NEED TO BE AWARE OF IN THE REVOCATION PROCESS?

Revocation orders made under section 14(1) attract a right to compensation by anyone suffering damage in consequence of the order by way of (a) depreciation in value of a land interest or (b) disturbance of his enjoyment of land. Authorities can therefore require assurances that no claims for compensation will be made or that they are suitably indemnified against such claims before using their powers. No such rights arise in relation to the use of section 14(2) powers, however, the authority may require evidence which demonstrates that a prescribed scenario has arisen and this can be hard to collate without input from the HSC holder.

Although making and confirming a revocation order is not a complex process, the reality is that many authorities are more used to wearing their Local Planning Authority hats than their Hazardous Substances Authority ones. So while the process of getting a revocation order confirmed by the Secretary of State is relatively straightforward there is typically some uncertainty as to the steps the Hazardous Substances Authority will take at the beginning of the process to actually make the order. Different authorities take different routes to make the revocation order depending on their internal processes. Given the general unfamiliarity of authorities with their powers/functions under the Act, this can lead to delay and confusion. Errors by a Hazardous Substances Authority at the front-end can cause unnecessary delays at the confirmation stage with the Secretary of State. Much also depends on the HSC holder who may need to provide written assurances to the authority to help the process along.

Having assisted on a number of revocation orders, our suggested practical points for anyone involved in obtaining a revocation order are:

1. seek to agree an action plan with the Hazardous Substances Authority early on to clearly establish what powers it will be using, what steps it will be taking to make the order and what information it requires from the HSC Holder;
2. encourage the HSC Holder to provide sufficient information that enables the authority to use s14(2) powers if possible. Where s14(1) powers are to be used the HSC Holder will need to confirm that it does not intend to pursue a compensation claim;
3. there is no need for public consultation (the Act only requires notice to be served on a very limited group, namely landowners and those affected by the revocation);
4. it may be prudent to avoid determination by committee and to stick within a Hazardous Substances Authority's delegated powers;
5. engage early with NPCU to establish what they require to be submitted to them and relay this information to the Hazardous Substances Authority;
6. establish a good working relationship with legal officers at the Hazardous Substances Authority if they will be assisting with the order making process and be on hand to assist them as necessary.

CONCLUSION

The pressure to increase housing land supply in our cities means that we are increasingly going to see HSCs needing to be revoked in order for development to be de-risked and brought into beneficial use.

Policy may keep moving forwards but it will be necessary to address redundant HSCs if the housing and economic growth our politicians want to see is to be achieved. Hazardous Substances Authorities will need to become more confident in their powers and more proactive in revoking old consents.

Meanwhile, the more familiar developers are with the revocation process the better able they will be include appropriate conditionality into land contracts, navigate the planning process and to assist Hazardous Substances Authorities in driving forwards revocation orders when needed.

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Purpose-Built Student Accommodation

The Outlook

by Sadia McEvoy

The UK PBSA sector has seen vibrant growth in recent years and, as an asset class, PBSA has rapidly become institutionally acceptable. In this article we look at the current market and some of the issues to consider.

Ashurst has gained significant experience in recent years advising clients in relation to purpose-built student accommodation (PBSA), and it is easy to see why. This burgeoning sector has a number of attractions for investors.

Tenancy rates are high and cash flow is relatively secure, whether due to initial government funding or to the "bank of mum and dad" when students find themselves short and the rent is due. In times of recession, student accommodation is relatively cushioned. Furthermore, anglophone countries, such as the UK, Australia and Ireland, benefit from an education industry centred around the English language, which has enduring international appeal.

In the words of British newspaper the Financial Times, "student accommodation is not merely a small-scale and idiosyncratic development; it is an early example of a vast move to gain exposure to rental property, instead of financial securities". The driver behind this shift is low returns in bond markets. According to investment manager M&G, student accommodation can provide a premium over public bonds. Thus, PBSA has become an institutionally acceptable asset class.

For British universities a decline in government funding, increased competition for students, and ambitions for expansion have led to an ideological shift in the Higher Education sector where students are now akin to customers and universities are increasingly aligned with the private sector. This marketisation of higher education has facilitated a new approach to student accommodation.

Universities recognise that a factor in attracting students, and thereby meeting the financial challenges they currently face, is the quality and cost of the accommodation offering. Indeed, research undertaken by international estate agent Knight Frank in conjunction with UCAS (the Universities and Colleges Admissions Service, whose main role is to operate the application process for British universities) – the Student Accommodation Survey 2018/19 – found that accommodation was the most important factor influencing student wellbeing across the UK, outranking factors such as a good campus atmosphere and pastoral care.

The findings of the Student Accommodation Survey 2018/19 indicate that around 30 per cent of full-time first-year students now live in PBSA, up from 22 per cent five years ago. The corollary is that the number of students in the private rented sector or living at home has declined, while the number of students living in halls or in accommodation provided by the university remains roughly the same. The research also found that a higher percentage of students were happy with their choice of PBSA than those who had chosen the private rented sector.

Evidence indicates that students want PBSA and the market has continued to provide it. In 2018/19, the number of PBSA bed spaces in the UK reached 627,115 according to US-based commercial real estate company Cushman & Wakefield, and the development pipeline is strong. International interest in the UK PBSA sector also appears buoyant despite Brexit, as illustrated, for example, by Singapore Press Holdings' purchase of a portfolio of properties owned

by the leading PBSA provider, Unite Students, for £180.5 million in September 2018. But what factors should investors be considering as the UK PBSA market continues to develop?

INTERNATIONAL STUDENTS

The Student Accommodation Survey 2018/19 confirmed various patterns regarding international students, who constitute around 22 per cent of the UK student population. International students are the group most likely to rent and are more likely than UK-based students to stay in the same accommodation for more than a year. Non-EU students are less likely to have an issue with the affordability of their PBSA than EU students. Non-EU students are also the group most likely to have their rent paid by someone else, for example, parents or wider family. For investors, these findings confirm the importance of international, non-EU students to the success of the PBSA sector.

UCAS figures from 2017/18 indicate that, while applications from UK students fell, applications from both EU and non-EU students increased. The growth in non-EU student numbers is particularly strong, and rose by 6 per cent in 17/18, driven perhaps in part by the relatively weak value of sterling. China sent more students to the UK than any other overseas country and current fears regarding stagnation in the Chinese economy have raised concerns that if Chinese students choose to stay at home or look elsewhere for higher education opportunities this could have a major impact on the UK PBSA sector.

While Brexit is unlikely to have a significant impact on numbers of non-EU students, for EU students there are a number of uncertainties. The two key questions - which remain unresolved at the time of writing - will be arrangements for fees (currently EU students pay the same fees as UK students) and access to student visas.

Arguably, the risks attached to losing EU students are less than those in relation to non-EU students because there are fewer of them. For example, UK PBSA operator Watkin Jones does not really feature Brexit in its demand forecasts because less than 7 per cent of students come from the EU. Watkin Jones' figures indicate a robust secured development pipeline comprising 17 sites, representing 7,534 beds, and reflect the widely held assumption that the strength of the domestic market, combined with ongoing interest from non-EU countries, indicates a healthy outcome for PBSA in 2019/20. Nevertheless, the significance of Brexit to the sector's investors may well depend on the geographic location of assets. A disproportionate number of EU students are based in London- for example, 18 per cent of the London School of Economics' students are from the EU – arguably making London-based investment a riskier proposition post-Brexit.

More broadly, the risks posed by Brexit in terms of potential loss of EU funding for research at UK universities (which amounted to almost £1 billion at the time of the referendum), and the "brain drain" of European talent, could reduce the attractiveness of UK universities to overseas students. Therefore, although the direct detrimental impact of Brexit on student numbers may not be significant, the indirect consequences flowing from a reduction in the quality of UK higher education could be of more enduring significance.

OTHER CHALLENGES

Over the last ten years, despite the introduction of tuition fees, there has been a steady increase in the number of UK-domiciled 18- and 19-year-olds going to university. However, domestic demographics indicate a decline in the birth rate that has led to fears of declining numbers in higher education. Added to this threat is the Government's drive to encourage more school leavers to participate in apprenticeships or undertake T Levels (technical exams in lieu of A-levels) rather than pursue a degree. However, statistics indicate that the demographic decline will be reversed from 2021 and there is also an argument that in times of uncertainty, such as now, people look to upskill to mitigate the risk of unemployment and therefore we may see more students, rather than fewer, in the next few years.

Another uncertainty facing the PBSA sector is the future of higher education itself. Academics opine that the role of universities has changed throughout history. From the home of medieval spirituality, to centres of technological innovation in the 21st century, universities have become quasi-businesses motivated by self-interest in a competitive market landscape. If this remains the case, universities will have to continue to customise education to meet their students' demands. This will mean providing a flexible learning experience, available 24/7, enabling students to work and learn online or on campus. Degrees may not be the only qualification on offer, as the rapidly changing needs of the labour market demand frequent reinvention and hence new skills. As the costs associated with a university education continue to rise, the motivation to learn remotely while working, or to live at home, may begin to outweigh the benefits of living and socialising within the physical environs of a university.

NATURE OF FUTURE DEVELOPMENTS

While predicting the future shape of education and the long-term impact of Brexit is, to say the least, challenging, in the shorter

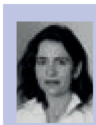
term the future of the PBSA sector seems assured. Nevertheless, the product will continue to evolve and be refined. In the Student Accommodation Survey 2018/19, affordability was, unsurprisingly, critical to students' overall attitude towards PBSA, and scaling up the size of developments, together with flexibility on the types of rooms available, is seen as a way of achieving this. Increasingly, future developments may also look to ensure that accommodation can be used in holiday periods on a hotel/hostel basis in order to maximise revenue. The London market, for example, is problematic in terms of affordability, but has greater potential to benefit from alternative use outside of term time.

We may also see an increased focus on top-ranking universities at the expense of lower-ranking institutions. For example, world-renowned Russell Group universities are more likely to attract international students and hence interest from the PBSA market. A vicious circle could ensue where struggling universities cannot attract students because their accommodation is poor, but PBSA operators are not interested because they do not have enough students. This could see a widening of the gap between "elite" UK higher education institutions and the rest. However, interest in PBSA even at top-ranking universities is subject to location factors. Research indicates that students are happier, and rental yields are more secure, the closer accommodation is to campus. Securing development opportunities within this range is challenging in many UK cities, particularly London, where availability and cost increasingly preclude development in zones 1 and 2.

In terms of new builds, there is scope for PBSA to benefit from smart construction methods, in particular, off-site manufacturing. Off-site manufacturing – where components or entire units are assembled or fabricated before reaching the construction site - has proven financial benefits and is being promoted by the UK Government as a means of mitigating the current housing crisis. Because modules and components are produced to standardised systems a more consistent product can be achieved, enhancing the quality of a project as well as reducing the chances of delay and disruption. Whereas off-site manufacturing has historically been linked to aesthetically uninspiring buildings, modern digital manufacturing methods mean that architectural ambition can be fostered and not compromised by off-site methods. Irish construction company Graham Group is a proponent of off-site manufacturing and is set to use it on the University of York's current 1,400 bed student accommodation project. As well as delivering the accommodation, Graham Group is an investor as part of a consortium with fund manager, Equitix.

Across the real estate sector more broadly, we are seeing much greater focus on creative placemaking as a means of nurturing wellbeing, and this emphasis has not been lost on the PBSA market. Contented students means more students, and therefore monetising wellbeing by creating student communities instead of building merely for functionality has huge potential upsides for everyone involved. Cushman & Wakefield, for example, in its 2018 Student Accommodation Report, observed that future developments must look not just to room quality but to amenity spaces "to support the student experience, interaction, collaboration and good mental health". Its research indicates that providers taking this approach were able to secure a 3 per cent increase in rent in contrast to those with poorer quality spaces which managed only 2.5 per cent. This more holistic approach can be seen in action in the promotional material for the University of York's new PBSA, which states that the new residences will include "flexible and welcoming communal space", "a safe, secure and comfortable environment", "views of the lake and parkland" and "a sense of belonging".

If the future of PBSA is affordable high-quality accommodation with attractive communal spaces that foster wellbeing and community, then it is a win-win for students and universities. For investors, for the time being, the figures speak for themselves: student numbers are growing, they want PBSA and the appetite from domestic and international markets remains strong.



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Recent UK Real Estate Tax Changes

Thoughts on Impacts on inbound Investment Structures

by Paul Miller, Simon Swann, Tim Gummer

We have seen very material amounts of investment over the last few years into the UK real estate market from overseas, particularly Asian, investors. Some major shifts in UK tax policy and rules mean that both new and existing structures need to be considered afresh.

BACKGROUND

We have seen very material amounts of investment over the last few years into the UK real estate market from overseas, particularly Asian, investors. Those investors have historically used a number of tax efficient structures. After a long period of stability in relation to such structures, there have been a number of recent changes though we are now reaching a stage where the shape and consequences of those changes are coming into focus. This article set out our thoughts on the position and some possible future trends and opportunities.

HISTORIC POSITION

By way of recap, until very recently, non-UK resident investors buying UK commercial property for a medium to long term hold faced a fairly benign UK tax regime. First, the use of leverage, both from third party and shareholder or other connected lenders often enabled non-UK resident investors to ensure a relatively low level of UK tax on rental income. Second, there was generally no UK capital gains tax chargeable on any increase in value of the property over the period for which it was held. Both of those points are changing as set out in further detail below. Third, the use of single asset special purpose companies ("**PropCos**") or Jersey property unit trusts ("JPUTs") allowed for transfer duty efficiency, i.e. stamp duty land tax ("**SDLT**") efficiency.

THE MAIN SETS OF CHANGES

There are three major changes in the offing. One of these changes (the so-called structures and buildings allowance) is good news for taxpayers in that it reduces their tax bill by increasing the amount upon which tax deductions can be claimed. The other 2 changes are, in many cases, much less positive for taxpayers. The first is the introduction of the corporate interest restriction. The second is the introduction of capital gains tax on all commercial and UK real estate even where the owner is non-UK resident.

This article looks at those changes in the context of investment into UK commercial real estate only. There are other issues for residential property and/or developers that are not covered below.

TAX ON NET RENTAL INCOME – IMPACT OF CORPORATE INTEREST RESTRICTION

As noted above, many investors have utilised interest on both bank debt and shareholder debt to reduce their UK taxable income. There were some limitations, most pertinently under the so-called transfer pricing rules. Those rules capped the amount of tax deductible interest to the amount that would have been payable to unconnected third party lenders. In times of plentiful liquidity, particularly where mezzanine investors were lending at high LTVs, those rules did not prevent material amounts of allowable UK tax deductions, even on interest on shareholder debt. Investors which utilised such planning needed to

consider their home jurisdiction tax treatment of the interest receivables but in many cases the careful utilisation of shareholder debt increased post-tax internal rates of return ("**IRR**").

That is now changing. In large part due to the Organisation for Economic Co-operation and Development ("**OECD**")'s recommendations about certain aspects of multi-national tax planning, known as their base erosion and profit shifting (aka BEPS) initiative. The OECD BEPS recommendations have a number of aspects but the one most relevant here is that they recommend that countries introduce much more restrictive rules around interest deductibility. The corporate interest restriction ("**CIR**") rules form part of that change (and are sometimes therefore known as BEPS Action 4). In this context those rules essentially cap the amount of tax relief for interest that is available.

The detail of how those rules work is well beyond the scope of this article but, in practice many PropCos or JPUT investors will find that, as from April 2020, their interest costs will be capped at the highest of the following:

(i) £2 million (reduced if the PropCo/JPUT investor is part of a "group" as defined for IFRS purposes);
(ii) 30 per cent of the PropCo/JPUT investor's EBITDA; or
(iii) the genuine third party interest costs (i.e. no deductions for shareholder interest).

The result of all that is that in a wide range of cases, as from April 2020, PropCos or investors in JPUTs will be allowed tax deductions for the third party interest costs but not for shareholder interest costs (unless they can avail themselves of the £2 million rule). The modelling we have seen shows that change having a material impact on post-tax IRRs.[1]

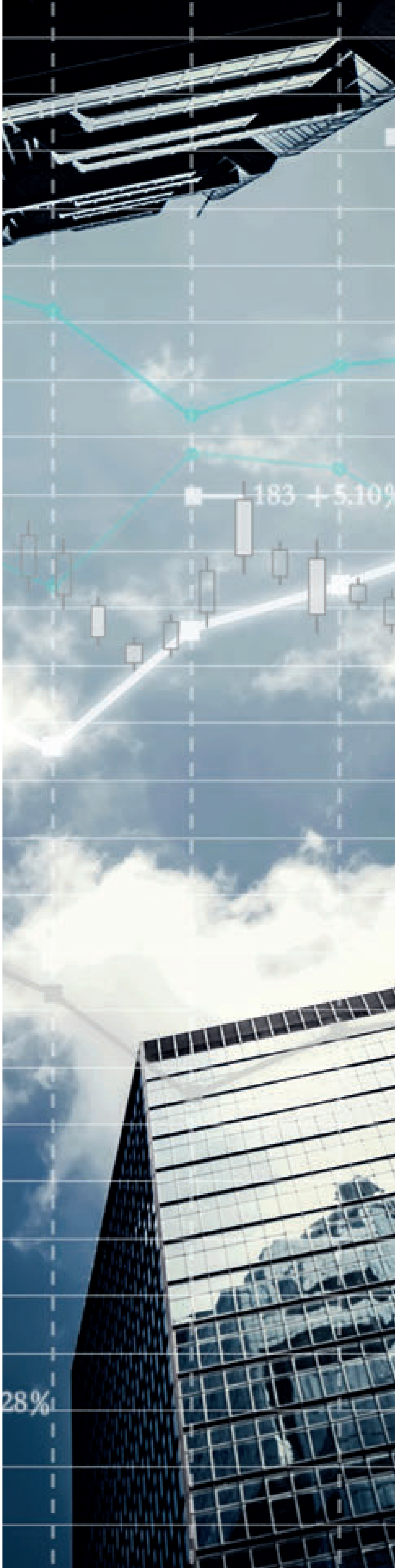
OTHER TAX ATTRIBUTES AND STRUCTURES AND BUILDINGS ALLOWANCE ("SBA")

The potential impact of the CIR rules has meant that many investors have been looking much harder at the availability of other tax attributes. For example, we are seeing much more interest in the availability of either: (i) brought forward tax losses; or (ii) what the UK calls "capital allowances" (which are the tax equivalent of depreciation).

For many years, capital allowances have been available on items such as elevators, fire alarms, heating and cooling systems, sprinklers and the like, known in the tax legislation as "plant and machinery". Whilst that initially seems pretty restrictive, in many buildings we find that anywhere between 5 and 65 per cent of the build cost on a new building could be made to fall within this head. However, for the remaining build cost, there was no tax deduction available.

That has changed with effect for new construction expenditure incurred pursuant to construction contracts entered into on or after 29 October 2018 on commercial buildings. There is going to be a straight line 2 per cent per annum tax deduction to be made available. That is good news, but in a sense

1. Technically, the way in which this CIR has been introduced is by bringing all overseas resident companies holding UK real estate into the corporation tax regime as from April 2020. Currently and for historic reasons, such companies pay income tax (which contains no CIR) rather than corporation tax. The move to bring such companies within the corporation tax rules has a number of other consequences, some beneficial and some not so, but they are much less seminal.
2. More particularly, vehicles will be "property rich" where both: (i) the shares or units directly or indirectly derive at least 75 per cent of their value from UK land; and (ii) the seller (or persons connected with him) holds at least 25 per cent of the interests in the vehicle whose shares or units are being sold. Where the vehicle also constitutes a "collective investment scheme", condition (ii) above is, in effect, deemed satisfied.



it is only a timing benefit. That is because the amount of SBAs claimed will reduce the base cost of the building for CGT purposes and will effectively therefore be recaptured on a sale. Nevertheless, that timing benefit could have a marked impact on IRRs, particularly where there is a long hold period.

The UK property industry had been lobbying for some time for something along these lines and it is undoubtedly welcome. There is further detail in our recent briefing, this can be found on our website on the news and insights page (Nicholas Gardner, "New depreciation allowance for commercial structures and buildings", ashurst.com (21 January 2019).

NON-RESIDENT CAPITAL GAINS TAX ("NRCGT")

From 6 April 2019:-

(i) where a PropCo or JPUT itself sells land, there will be UK tax charged on any increase in the value of the land accruing after April 2019; and

(ii) where any entity sells shares or units in '*property rich*' vehicles, there will be UK tax charged on any increase in value of the shares/units accruing after April 2019. PropCos and JPUTs will almost invariably be "property rich" for these purposes[2].

The main possible reliefs are that:

(a) certain tax treaties (most notably the UK/Luxembourg treaty) may not allow the UK to levy tax on a sale of shares in a PropCo by its Luxembourg-resident holding company. The UK Government is seeking to amend the Luxembourg treaty as a matter of urgency;

(b) any gain which accrued prior to April 2019 will not be subject to NRCGT. One can either obtain a valuation as at April 2019 or, in some cases, an alternative statutory rebasing may be preferable;

(c) importantly, but perhaps somewhat oddly, the charge at (ii) above does not bite where the seller is itself owned as to at least 80% by certain types of "qualifying institutional investors". The question of what that term covers in an international context is assuming increased significance and is something we are seeking further clarity on from HMRC; and

(d) there is an exemption for disposals of interests in "property rich" entities that themselves use the land for a trade carried on by them or their group both before and after the disposal. That exemption will be more useful for many property-intensive businesses (e.g. retail or hotel operators) but not for pure property investors.

ISSUES

The NRCGT rules could cause multiple levels of tax and can cause issues for funds, where some investors are exempt due to their status (e.g. as a sovereign wealth fund or certain pension schemes) and some are not tax exempt. Accordingly, the Government has introduced two elections that can be made by certain types of fund vehicles. The elections are called the "Transparency Election" and the "Exemption Election". Each has been introduced to deal with the specific issues faced by funds.

THE TRANSPARENCY ELECTION

This is mainly relevant to JPUTs and the remainder of this section of this note focuses exclusively on JPUTs. Absent the Transparency Election, as set out above, the JPUT will itself become subject to tax on capital gains on disposals of UK land.

The effect of the election, which is irrevocable and must be made with the unanimous consent of unitholders, is to treat the JPUT as a (tax-transparent) partnership so that each unitholder is deemed to own a fractional share of the underlying assets. Accordingly, a direct disposal by the JPUT of an interest in UK land is treated as a direct disposal by each of the unitholders. That will be useful for investors who have a complete exemption from UK tax; key examples being UK pension funds and certain sovereign wealth funds and similar state bodies which benefit from sovereign immunity from UK taxation.

THE EXEMPTION ELECTION

This is a complicated elective regime designed primarily for multi-asset funds which meet certain conditions. The election is made by the fund manager and can be made at any time in the investment cycle of the fund (although it only applies to disposals made after the election). The election may also be revoked. Some key points:

(a) the basic idea behind the Exemption Election is to permit qualifying funds and their subsidiaries to make disposals (direct or indirect) on a tax free basis to enable the proceeds to be reinvested;

(b) gains are nevertheless still taxable on repatriation to end investors on the winding up of the fund or, if earlier, where the qualifying conditions for the election cease to apply;

(c) there are wide annual reporting requirements pursuant to which the fund manager is obliged to notify HM Revenue & Customs of the names and addresses of all investors in the fund, the values of any disposals of fund interests during the relevant year and certain other information; and

(d) disposals of interests in the fund vehicle at a gain remain chargeable to UK corporation tax on chargeable gains (however small either the investor's total interest in the fund vehicle or the interest disposed of).

IMPACTS OF THOSE CHANGES

The overall impact of all the changes has yet to bed down but we can already see a number of trends:

1. the impact of these rules (and a number of analogous rules in other major EU jurisdictions) mean that pan-European real estate funds may become more popular than single jurisdiction real estate funds;
2. for many investors the loss of shareholder interest deductions will materially impact their expected return and they are naturally very disappointed by the introduction of the CIR rules. However some classes of investor (particularly taxpaying investors in countries with historically high rates of tax such as the US and Japan) were generally unable to efficiently utilise shareholder loans. From such investors' perspective, the fact that shareholder interest will rarely be deductible in full as from April 2020 could well level the playing field somewhat;
3. certain types of property will become more tax efficient. In particular, the SBAs discussed above only apply to works carried out pursuant to contracts entered into after 29 October 2018 which will make those new buildings more tax efficient investment opportunities. Similarly, the £2m de minimis rule under the CIR means that buildings under circa £60-70m may become a popular target for some investors - particularly in a club deal context where the IFRS grouping rules will not apply to dilute the benefit of the £2m de minimis across the group;
4. the issue of how to discount the price of a PropCo (or JPUT where there is no exemption election) to take account of any "pregnant" gain will assume increased importance in the UK market;
5. fundamentally, the use of single asset PropCos and JPUTs is likely to remain prevalent, at least in the short term, for a number of reasons;
6. historically, non-UK pension funds have not looked too hard at whether they ought to be allowed the same UK tax breaks as UK pension funds. That will change. Similarly a number of non-UK quasi-governmental funds or pension schemes may want to reconsider whether they can claim sovereign immunity from UK tax;
7. the position for a UK REIT is now close to that of an offshore fund that has made an exemption election. The good news for UK REITs is that their capital gains exemption has been extended. The bad news for REITs is that investors in their shares will now generally face a tax charge on the increase in value of those shares accruing after April 2019; and
8. the tax modelling we are producing has become more complex. There needs to be much greater focus on efficient utilisation of losses, interest and capital allowances given the various different caps and rules around their uses.

OUTLOOK AND FUTURE CHANGES

The pace of change has slowed more recently. A general election leading to a Corbyn-led Labour Government would undoubtedly bring more changes. But, absent that, we would expect to see a period of some consolidation (with tweaks as problems emerge) rather than further wholesale change over the next few years. That is, of course, assuming that the Government is not tempted to introduce a charge to SDLT on transfers of interests in "property rich" vehicles, now that they have a definition of that concept.

If want to drill down into any particular aspects of our thinking in this article, please contact the authors of this article or your usual Ashurst contact.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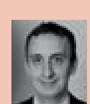
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