

IPS Property Guidance Notes

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A. Introduction

These notes are for guidance and IPS encourages you and your other professional advisors to contact IPS to discuss queries. Please ensure that all the professional advisors are provided with a copy of these notes. IPS would be happy to e-mail copies of these notes upon request, or they can be obtained from our website.

The purpose of these notes is to assist the Member(s) and their professional advisors when considering property investments.

Arranging the purchase of a property within a pension scheme is likely to be one of the most complex investment transactions undertaken by the pension scheme, not only because of the nature of the investment but also because of the number of professional advisors who may be involved (e.g. solicitors, valuers, banks, financial advisors).

An initial point to note at the outset is that the pension scheme Member(s) is also a Trustee alongside the pension scheme trustee company. Many instructions required to be given by the trustees can be made by the Member(s) Trustee on behalf of the trustees. The Member(s) Trustee, therefore, has a key “hands on” role to play to ensure that the transaction proceeds smoothly and that the various professional advisors work to the required timescales. IPS does not take on the responsibility to chase all the parties involved, although IPS will assist whenever possible.

Legislation in relation to pension schemes means that certain types of property investment can incur onerous tax charges and it is important that Member(s) Trustees have a working knowledge of some of the basic rules to be borne in mind.

IPS will require a Property Questionnaire and Resolution to be completed and sent to us, together with copies of supporting documentation, before we agree any transaction. The Property Questionnaire can be requested at any time and may assist when considering proposed investments as it prompts questions which assist when considering suitability of an investment. The Property Questionnaire is also available for download on our website.

IPS charge a one-off fee for dealing with property transactions, unless we are requested to deal with rent reconciliations – see Section P of this report, when an additional annual fee is also charged. Details of all our fees are in our pension scheme brochure and can be found on our website.

B. Who can a property be bought from, or sold / let to?

Under present legislation pension schemes are permitted to enter into transactions involving the purchase, letting and sale of property assets with any other party, regardless of any connection.

When the other party is deemed a connected party (see Section Q of these notes) HMRC require the pension scheme trustees to obtain independent professional advice to confirm the market values to place on the transaction. This is to satisfy HMRC requirements such that the transaction takes place on “arms length bargain terms”. Further details in relation to valuation requirements are mentioned in Section G of these notes.

NB: There could be onerous tax charges if HMRC, through the District Valuer, determine that a transaction has not taken place at market value if a connected party is involved.

When the other party is unconnected HMRC requirements do not dictate the need for independent professional advice, unless the transaction is directly or indirectly for the benefit of a connected party.

In some instances the pension scheme may require independent professional advice as to a fair price (or apportionment) even if the other party is unconnected. This is when a connected party is also entering into a transaction with the other party at the same time as the pension scheme (for instance, the pension scheme and the Member(s) personally are both buying property from an unconnected vendor as part of the same deal).

With any transaction the Member(s) Trustee can always decide to commission a valuation report, even if the other party is unconnected. The pension scheme can meet the cost of this advice regardless of whether or not the transaction proceeds. This may be a prudent course of action in any event, especially if the Member(s) Trustee has no other means of determining that the agreed transaction price is fair and does not prejudice the need for good investment value for the pension scheme.

C. What types of property are permitted investments?

HMRC rules on property investments mean certain property assets could be classed as “taxable property” if purchased and such property is not permitted to be held in the pension scheme. There are onerous tax charges if HMRC deem that the pension scheme holds “taxable property”.

The “taxable property” rules can be complex when considering a specific property investment, even to the extent that an adjacent or neighbouring property means that the property in question could be deemed taxable property.

Generally, most commercial types of property are permissible, e.g. Shops, Offices, Industrial Units. **Residential property investments, however, are NOT permitted.**

The lists below as to types of property permitted, and not permitted, are provided as examples only and you should contact IPS if you are unsure if the investment is allowable.

Property types which are generally permitted

- Shops, Retail outlets
- Industrial Units
- Offices
- Hotels
- Care Homes
- Public Houses
- Agricultural Land
- Land for commercial development
- Shop with integral flat all let to one unconnected party (for example high street newsagents whereby both the shop and flat is let and occupied by the person who runs the newsagents)

- Caretaker style accommodation - provided it is not occupied by a connected party

Property types which are NOT generally permitted

- Residential Property
- Holiday lets, timeshares, beach huts
- Commercial Freehold property if a long leasehold residential property is under the freehold (even if a nominal or peppercorn ground rent)
- Caravans, log cabins or other moveable property

Both Freehold and Long Leasehold property can be purchased. Long Leasehold property must usually have a minimum unexpired term of 75 years, with a ground rent of less than £100pa, to be considered an acceptable investment for an IPS pension scheme.

Please note that any property to be purchased requires IPS' agreement before proceeding. Please contact IPS to discuss any queries or talk through proposed property investments, or types of investment.

D. Types of property to be avoided

Property should be viewed as a long term investment and careful consideration ought to be given to its suitability as a stand alone investment for the pension scheme. Ultimately, the purpose of the property investment is to provide funds for retirement or death benefits under the pension scheme.

The reason for any purchase must always be capable of being proven to be for sound investment reasons, rather than, say, a means to provide a bespoke property for occupation by the pension scheme Member(s)'s company.

HMRC comment that "general trust law requires the trustees to act prudently, conscientiously and honestly when making decisions in respect of the scheme. Trustees should at all times act in the best interests of pension scheme Member(s) in their capacity as trustees and not as employees, directors, shareholders etc".

Generally, the types of property that ought to be avoided, even if they are of a commercial nature, could be:

- Unlettable property held for short term and sale/profit
- Property of a specialist nature which may be difficult to sell
- Property with a present or future risk of contamination or environmental issues
- Leasehold property with high ground rents, or review provisions for potential high ground rents

Pension schemes are permitted to purchase property overseas although this is very complicated and involves a number of additional issues. IPS have a separate guideline relating to overseas property.

E. Purchase funding (including Borrowing)

It is important that funding is in place before the pension scheme is committed to purchase any property. If money from new pension contributions or transfer values from other pension arrangements are required to enable the purchase to proceed, these funds should be in place before exchange of contracts.

Similarly, if funds from borrowing are required, the loan offer should be received before exchange of contracts.

Borrowing Limit

Borrowing by the pension scheme is permitted to a maximum level set by legislation. Aggregate borrowing must not exceed 50% of the net value of the pension scheme.

The maximum borrowing limit does not have any reference to the cost or value of the property asset being purchased, although the lender's own borrowing rules may have loan to value limits.

IPS will check that the maximum pension scheme borrowing limit will not be breached, although we may request the Member(s)'s assistance obtaining the necessary information to check this limit.

There are onerous tax charges if the pension scheme breaches the maximum borrowing allowed by legislation.

Care needs to be given when considering and calculating maximum borrowing if the pension scheme already has existing borrowing. The existing borrowing amount needs to be considered twice in the calculation, as indicated in the example below:

Example:

The pension scheme has been in existence for a number of years with various assets including a property with a mortgage. A new property purchase is being considered with an additional mortgage to assist the purchase.

The current value of all the assets of the pension scheme (including the existing property) is £700,000, although the existing mortgage is £200,000. This means that the current "Net Value" of the pension scheme is £500,000.

The maximum new borrowing is:

Value of all assets	£700,000	
Less existing borrowing	(£200,000)	
	£500,000	Net Fund Value
Divided by 2 =	£250,000	50% Net Fund Value (<u>Max aggregate borrowing</u>)
Minus existing borrowing	(£200,000)	
	£ 50,000	Maximum NEW borrowing

Borrowing repayments

Although the lender will, no doubt, have regard to the pension scheme's ability to service the borrowing repayments (usually by reference to rental income), the trustees of the pension scheme will also need to consider this affordability factor. It is important, therefore, that the Member(s) Trustee considers this aspect during initial considerations/proposals. It is not necessarily acceptable to rely on future pension contributions to meet the affordability factor because the payment of contributions cannot be made mandatory.

Obtaining formal offer

IPS does not arrange or source lending offers and it is the responsibility of the Member(s) Trustee to obtain a suitable offer which can be accepted by the trustees. The Member(s) Trustee may, of course, obtain the assistance of any professional advisor and the pension scheme can meet the cost of any advice given.

The offer letter must include a clause to limit the liability of the pension scheme trustee company to the extent of the assets of the pension scheme. We can provide some example wording for the clause in relation to the specific pension scheme upon request.

Please contact IPS if there are any queries whatsoever in connection with the funding and any proposed borrowing.

F. Instructing solicitors

The Member(s) Trustee must choose the firm of solicitors to be used in any transaction. IPS does not have a panel of recommended solicitors. Details of the solicitor are provided to IPS when our Property Questionnaire is completed and sent to us.

The solicitors should acknowledge that they are acting for the trustees of the pension scheme. If the solicitors are also acting for a connected party (e.g. the pension scheme Member(s)'s company as Tenant of the property), they will need to confirm that there is no conflict of interest. When necessary, IPS will issue a Trustees Resolution for the appointment of the solicitors to deal with this issue.

Upon receipt of our Property Questionnaire and when we are in a position to approve the property transaction, the pension scheme trustee company will write to the solicitor providing the relevant details of the purchase (as detailed on the questionnaire). The Member(s) Trustee will need to sign the solicitor's Standard Terms of Business prior to the pension scheme trustee company signing (if the solicitor requires the pension scheme trustee company to sign).

Apart from the usual property searches that the solicitors will arrange, they will also need to ensure that our standard liability clause for the benefit of the pension scheme trustee company is included in the purchase and letting documentation. When we are in a position to write to the solicitors with Standard Instructions, we will provide example wording for our liability clause.

If the solicitor is also acting for a connected party, separate bills/invoices will be required and the pension scheme cannot agree to pay the connected party's costs.

These notes are not all encompassing and the solicitor can contact IPS for further information at any stage, even if we are not in a position to agree a particular purchase.

G. Valuations and instructing valuers

The Member(s) Trustee must choose a suitable valuer to provide advice to the pension scheme trustees. IPS does not have a panel of recommended valuers. The valuer will need to be suitably qualified and IPS requires some form of RICS (Royal Institute of Chartered Surveyors) qualification.

As mentioned in Section B of these notes, valuations are mandatory when a connected party is involved in the transaction (whether directly or indirectly involved). If the valuer is also acting for the connected party, IPS will issue a Trustees Resolution for the appointment of the valuer to obtain confirmation that there is no conflict of interest.

The valuation advice must be addressed to the trustees of the pension scheme, which can be care of IPS', or the Member(s) Trustees' address. The valuer's invoice should be addressed to the trustees.

If the valuer is from a lender's panel and advises the lender as to Market Values, a side letter (or separate report) clearly addressed to the trustees of the pension scheme will be required.

The valuation report will need to confirm the usual definitions of Market Values as provided by the valuer's professional body, without any special assumptions.

The valuation report should comment on contamination / environmental issues and if specialist reports are recommended by the valuer, those reports may need to be obtained before proceeding further.

When advising Market Rent, the valuer should have regard to the proposed terms of the lease, including any break clauses.

If the valuation is for Market Value and there is an existing lease the valuation of Market Value must take this into account and not be on a vacant possession basis.

If the pension scheme is buying a property from a connected party who already occupies the property and will continue to do so upon change of ownership to the pension scheme, the valuation advice must first establish the "Market Rent" and then provide the "Market Value" subject to the proposed tenancy (the Lease Agreement for the tenancy will need to be drawn up by the solicitor to be executed simultaneously with the purchase).

H. Tenancies / Leases

As mentioned in Section B of these notes, the pension scheme can let the property to any party and when that party is connected the rent payable is subject to independent valuation advice.

The Lease documentation should be on normal commercial terms and include a clause to limit the liability of the pension scheme Trustee Company.

IPS does not have any particular requirements as to length of leases and the Member(s) Trustee should seek the advice of their professional advisors in this regard.

IPS will not agree tenancies by connected parties to be dealt with by “Tenancies at Will”. The lease document for connected parties must specify the lease term end date.

If any lease is to be surrendered early before the end of the term and the tenant is connected, a valuer’s advice will be required to confirm any premium payable for the surrender of the lease. This could be payable by the Landlord or Tennant depending upon which is instigating the surrender (in other words if the pension scheme Member(s)’s company rents property from the pension scheme but, say, needs to reallocate to larger premises, the valuer will need to comment on whether a premium should be paid by the company to the pension scheme if the company wishes the pension scheme lease to be surrendered).

Upon expiry of a lease to a connected party, a new lease must be put in place. It is not acceptable from the pension scheme’s point of view to allow any “roll-over”, even if property law allows. The pension scheme as landlord must always have a current written lease in place with its connected tenants.

The Member(s) Trustee will need to ensure, therefore, that all supporting rental valuations and new leases are dealt with in a timely fashion when an existing lease reaches its term expiry date. This should be borne in mind if the property is let on a short term basis, i.e. if a 3 year lease style, then every three years a market rental valuation and new lease will be required (the pension scheme can meet the cost of this).

If property is bought with vacant possession, or becomes vacant, consideration will need to be given to the affordability of the pension scheme as regards any maintenance costs which the tenant may otherwise be responsible for (e.g. vacant property rates)

Please contact IPS if there are any queries whatsoever in connection with Leases or proposed leases.

I. Environmental / Contamination / Property Law requirements

The Member(s) trustee will need to arrange for advice from suitably qualified people to consider all relevant aspects of property legislation. This could be before or during ownership by the pension scheme and the cost for such advice can be paid by the pension scheme.

In instances where it appears there are onerous covenants or obligations imposed on the pension scheme trustees through purchase/ownership of a particular property, IPS will not proceed with the investment until suitable advice is obtained and recommended remedial action, where necessary, applied.

Specific regulatory considerations to be aware of are as follows:

The Control of Asbestos at Work Regulations 2002

Regulation 4 came into effect on 21st May 2004 by when all commercial properties must have had specific asbestos management plans in place. The Health and Safety Executive are entitled to inspect the plan and criminal prosecution could result from non-compliance.

The regulations state that the responsibility for the management of asbestos, including the management plan, falls on the “duty holder”, defined as:-

‘every person who has an obligation under a contract or tenancy to repair or maintain property or where there is no such contract/tenancy every person who has control of the premises’.

A suitable assessment as to the presence of asbestos on the premises must be carried out, the results recorded and, if asbestos is present or is likely to be present, a management plan must be prepared.

In normal circumstances, the tenant is responsible for the maintenance of the property and will, therefore, be the “duty holder”.

Environmental Protection Act 1990

The legislation covers the identification and remediation of contaminated land. The regulatory regime has been in force since 1st April 2000 following implication under the Contaminated Land (England) Regulations 2000 (SI2000/227). Please note that these regulations apply throughout the UK.

Responsibility for remediation of contaminated land falls upon either the original polluter (Class A appropriate person) or, failing him, the current owner / occupier (Class B appropriate person). It is clear that pension scheme trustees, including the professional trustee, can be included in the definition of ‘owner’. However, it is the trustees who stand to benefit personally from the trust who will be directly liable (i.e. the pension scheme members).

Contaminated Land

In accordance with Law Society practice, solicitors are required to advise their clients regarding the consequences of purchasing contaminated land. The advice should include making enquiries of the vendor and statutory and regulatory bodies, obtaining a

site report and advising that a full site investigation be undertaken if necessary. Please note that surveyors are under no obligation to make enquiries about contamination unless specifically instructed to do so.

In future, prior to completion, we will need:-

- a) A copy of the site report and any further surveys undertaken.
- b) A copy of the Asbestos Management Plan.
- c) Confirmation that the lease will be on a full repairing and insuring basis, noting the tenant as the Duty holder for the purposes of the Act.
- d) Confirmation from the solicitor acting for the trustees that the issue of contaminated land has been addressed.
- e) A completed and signed property questionnaire and Resolution noting responsibility to comply with the regulations and limiting the liability of the professional trustee to the assets of the pension scheme.

Energy Performance Certificates

These will provide a rating of the energy efficiency and carbon emissions of all premises (with very few exceptions, such as places of worship and agricultural buildings), and include recommendations of how to improve the energy rating. For most properties they are required from the 1st October 2008.

Certificates must be provided for all property sales at the expense of the seller, and all leases at the expense of the landlord. A new certificate must be produced every 10 years, so for a lease being granted within a 10 year period, the current certificate will suffice.

Certificates are included as part of survey reports and property searches. In addition, an online register will be available from which copies of existing certificates can be obtained.

Penalties of up to £5,000 will be levied for non compliance.

Please contact IPS for further information and guidance at any stage.

J. Insurance

It is the responsibility of the Member(s) Trustee to arrange insurance, for the benefit of the pension scheme, to be in place from exchange of contracts. The solicitor should not allow a transaction to proceed unless the appropriate insurance is in place.

The solicitor may also advise or recommend other insurances in relation to the property title. The pension scheme can meet the cost of any insurance (unless it is payable or rechargeable to the vendor/tenant).

The Member(s) Trustee must ensure that the insurance is promptly renewed each year and send IPS copies of the relevant certificates. The pension scheme trustees' interest will need to be clearly identified on insurance certificates.

Please contact IPS for further information and guidance at any stage.

K. Joint Ownership

The pension scheme is permitted to purchase and own property with any other party (co-owner), if the co-owner accepts joint ownership.

The co-owners could be other pension schemes, or the Member(s), the Member(s)'s Company, or a completely unconnected party.

The solicitor will need to prepare a Declaration of Trust to record the percentages of co-ownership and deal with pre-emption rights (the pension scheme must be able to force a sale of property at any stage - for instance to pay death benefits). IPS can provide the solicitor with an example Declaration of Trust upon request.

The pension scheme should receive its share of rental income in relation to the percentage ownership and generally all income and expenditure in relation to the property will need to be correctly apportioned between the pension scheme and the co-owner(s). This can lead to complicated property administration procedures for the Member(s) Trustee to contend with and this should be borne in mind at the outset.

Further complications can arise if either or both parties raise finance for the purchase through a mortgage and the property is to be used as security. The legal mortgage/charge document needs to include cross default clauses. The solicitor will need to ensure the correct wording exists in the documentation.

By way of example.....say the pension scheme does not borrow but the co-owner does.....if subsequently the co-owner defaults, the mortgagor should not be capable of using the pension scheme's share of the property to repay the co-owner's debt. The fact that the mortgagor can obtain possession of the property and sell it, it is an investment risk which must be fully understood at the outset by the Member(s) Trustee (otherwise the transaction should not proceed).

Joint ownership can be complicated, especially when mortgages are involved. Please contact IPS for further information and guidance at any stage.

L. VAT

If the property is subject to VAT, the pension scheme can register for VAT and the Member(s) Trustee will need to arrange for this to be dealt with (usually by their accountant or person who deals with their business VAT administration). IPS are not VAT experts and it will be necessary for the person who deals with the VAT to advise the trustees accordingly in all aspects of VAT.

The effect of VAT on the funds needed to achieve the purchase also needs to be borne in mind by the Member(s) Trustee when considering the property investment.

Stamp Duty Land Tax is usually payable after VAT is added to the purchase price and the Member(s) Trustee will need to bear in mind that the addition of VAT can push a purchase into the next Stamp Duty threshold.

After the property is bought, VAT on rents will need to be charged and invoiced accordingly. Quarterly VAT returns will be required and the Member(s) Trustee

needs to consider who will deal with this aspect of the property administration and arrange for this to be dealt with.

Please contact IPS for further information and guidance at any stage.

M. Property Development/Refurbishment

The cost of any work undertaken by the pension scheme as Landlord needs to be properly invoiced to the trustees of the pension scheme. It should be borne in mind that VAT costs may be an issue, especially if the property/pension scheme is not currently VAT registered.

Contractors must be prudently chosen by the Member(s) Trustee and can be the Member(s)'s business if that is the nature of their business. However, if the work is carried out by a connected party, it will be necessary to provide evidence that the contract price is on an arms length commercial basis. This means verification by a suitably qualified professional (e.g. Quantity Surveyor), or the provision of three alternative quotations.

Work must not commence without contacting IPS beforehand for agreement to the proposals.

When there is an existing tenancy, work on the property must be carried out and paid for in accordance with the terms of the lease. If necessary, the Member(s) Trustee may need to arrange for advice from a suitably qualified person to establish whether the pension scheme as Landlord, or the Tenant should arrange/pay for the necessary works.

If the work is for, say, a new extension, written agreements between the Landlord and Tenant must be drawn up before any work is undertaken. Agreement for the revised rent after completion needs to be made which will depend on whether the landlord or tenant undertakes the work. If the tenant is connected a valuer's advice will need to be sought.

Please contact IPS for further information and guidance at any stage.

N. In-Specie Transactions

Transfer Value Payments

Property can be received into pension schemes by virtue of transfer value payments from other pension arrangements. IPS will need to approve the transfer before it proceeds. Just because property is held by one pension scheme does not necessarily mean it can be transferred to another. For instance, under the existing pension scheme, the property investment may be protected from HMRC rule changes by grant of transitional protection by HMRC. Such protection may be lost if the property is transferred to another pension scheme.

IPS will need full details of the property and other assets representing the transfer value payment from the other pension scheme before we can consider approving the transfer. When the transfer involves mortgaged property, The IPS pension scheme will need to obtain its own mortgage to replace the existing one and the Member(s)

Trustee must arrange this. A maximum borrowing test will also need to be undertaken.

The Member(s) Trustee will also need to arrange for a solicitor to deal with the transaction on behalf of the IPS pension scheme and should be aware that there will be costs accordingly (other than IPS fees).

Contributions

In some instances unencumbered property can be transferred to the pension scheme in the form of a new pension contribution. Stamp Duty Land Tax and VAT will be payable as with any other purchase and these elements cannot form part of the contribution (i.e. the pension scheme will need cash funds to pay for Stamp Duty and VAT when these costs are applicable).

In-specie contributions can also often generate a capital gains tax liability based on the value of the property at the date of transfer.

We have separate notes covering in-specie pension contributions which are available on request. Those notes detail our additional fees for in-specie pension contributions.

In-specie transactions can become complicated and involved. Please contact IPS for further information and guidance at any stage.

O. Managing the Property Investment

The Member(s) Trustee must make arrangements for any property asset to be actively managed so as to protect the integrity of the property investment. The management of the property in this regard includes consideration of all statutory requirements that may be placed on the pension scheme as a property owner/landlord. Regard also needs to be given to ensuring tenants meet their obligations under a lease (e.g. maintaining, repairing, decorating requirements etc).

The Member(s) Trustee can arrange for any professional advice necessary from suitably qualified people to satisfy this requirement, including the formal appointment of a property management agent. The pension scheme can meet the associated costs.

Before completing a property purchase the Member(s) Trustee will need to sign a Trustees Resolution acknowledging the position as regards property management.

Please contact IPS for further information and guidance at any stage

P. Rental Reconciliations (information for HMRC)

Information to be reported to HMRC includes details of unpaid rents by connected parties (outstanding rent can involve onerous tax charges) and details of rent receipts from properties which were originally acquired from both connected and unconnected parties.

The Member(s) Trustee will need to provide all relevant information to IPS when requested in a timely fashion, or procure the provision of the information from any duly appointed property managing agent.

When signing IPS' Property Questionnaire, the Member(s) Trustee acknowledges the need for the provision of the information. IPS reserves the right to request the provision of the information in any instance, even if rent is paid into the IPS Designated Client Account.

Please contact IPS for further information and guidance at any stage

Q. "Connected Parties"

The definition of connected parties is complex and ultimately defined under Section 839 of the Income and Corporation Taxes Act 1988.

Please inform IPS of any connection whatsoever between the pension scheme Member(s) (or their family) and any party which the pension scheme enters into any transaction with.

Generally, connected parties could be the pension scheme Member(s), their family, anyone they are in partnership or business with and their spouse, any co-trustee or settlor of any settlement they are a trustee of, and any company where the persons own more than 50% of the voting rights.

It is important to remember that any connection does not in itself prevent the property transaction proceeding, but does mean that independent professional valuation advice is required beforehand. **IPS reserves the right to request such valuation advice in any event.**