LONDON PROPERTY SUMMIT 2013

Will the international love affair with our Capital's property continue?

On an unexpectedly bright October afternoon, FTI Consulting, as part of the London Property Summit, hosted a discussion exploring the international love affair with our Capital's property and the potential opportunities and pitfalls of investing. Hosted by Giles Barrie, Managing Director, FTI Consulting Strategic Communications Practice and former editor of Property Week, the panel included Ciaran Carvalho, Partner in the Nabarro Real Estate Team and Head of the Real Estate Group; Bas Kundu, Managing Director in the FTI Consulting Real Estate Practice; and Tim Haynes, Senior Managing Director in the FTI Consulting Construction Solutions Practice.

Who's Hungry For UK Real Estate?

Opening the discussion, Ciaran Carvalho identified key themes and highlights from research conducted in spring 2013 by Nabarro and FTI Consulting. Over 3000 UK based and international investors were surveyed. It quickly became apparent that London is very much where international investor capital is directed. Over the next two years 73 per cent thought that investor and occupier appetite for UK real estate would continue and that the attractiveness of the Capital would increase. Furthermore, 64 per cent thought it would continue to increase over the next five years, illustrating the longevity of its appeal.

What are the drivers for investors?

Various drivers may be cited: a strong legal framework; economic stability; and the English language (English remaining the international language of business, which makes us very fortunate, if not a little lazy). Events across Europe and the Arab Spring have all contributed to international capital entering the country, which is seen as a safe haven. Furthermore, with high grade London property, investors always have an exit route for the investment, much like a bond (although transacting takes a little longer). This is an attractive proposition. Investment performance benchmarking was also highlighted as a driver as it raised the standard of professional practice levels in the industry.

Drivers for occupiers. Why be in London?

The educational system is a huge draw for overseas investors who educate their children in London and have an affinity with the Capital. In addition, London is seen as a capital of culture which can be rivalled only by a handful of world cities.

What do investors have the appetite for?

While investment in offices remains high, the growth in appetite for the residential sector is significant. Frequently considered a top asset class internationally, in the UK it has traditionally been seen as more troublesome for large scale investment.

Retail remains challenging due to the decline in the high street. However, there is a shift to distribution and logistics due to the rise of internet shopping. Asset classes that require additional operators and contractors such as student accommodation, leisure and hotels are often seen as a less attractive investment opportunity (at least initially due to the more intensive asset management requirements). Management contracts usually mean that the risk is carried by the owner rather than the occupier, so there is less certainty over income flows.

Common deterrents for investors and occupiers?

Current planning laws, a clunky tax system and the regulatory framework are all deterrents, whilst an ageing infrastructure network is also problematic.

Looking into the future

The UK sits centrally on the world map and business can be conducted easily from both the East and the West. At present the Middle East and Far East are the largest investors, though it's likely that the Far East will soon lead the pack. There is huge demand and scope for investment. Perhaps the only question to ask is how will we meet the demand?

How Competitive Is The UK Tax Regime For International Property Investors?

Bas Kundu, Managing Director, FTI Consulting, Real Estate Practice addressed the UK tax regime's competitiveness. Cited by research as the biggest deterrent for investors, Bas suggested that the stigma is perhaps unjustified.

The UK tax system could be described as long and complex and for those other than tax experts, pretty dull! On acquisition there is stamp duty land tax, during the holding period taxes on net rents and business rates in addition to VAT returns. On exit, capital gains tax is an issue and all of these have different rules to be considered.

Whilst the system may seem overly complicated, in comparison to the UK's major international competitors, it is comparable, and in a number of instances, better than their regimes in terms of the complexity of the system and the tax burden.

Business rates remain a major concern, as is stamp duty land tax regime that is four per cent on the purchase of an asset. Though painful on the way in, if you were to buy shares via a company or units in a unit trust, that rate would fall to 0.5 per cent or nothing on subsequent sale of the property enveloped in that structure. However, for residential properties that have a value of more than £2 million, this regime is becoming more onerous.

For non-REITS there is taxation on net rents, however, the tax rates are either 20 per cent for non-resident landlords or 23 per cent for UK corporates. This is still lower than for those in the United States and France.

Tax-efficient structuring

Efficient structuring is key to sheltering taxable profits. In terms of income or corporation tax on net rents, capital allowances and interest deductions are available, though in the UK capital allowances are received for fixtures and plants only, whereas in a number of other territories the whole building can be written off, albeit over a longer timescale. The UK allows interest deductions on an arm's length basis, and this can include an element of shareholder debt. Germany, the United States and France all apply more stringent interest capping rules.

In relation to capital gains, unlike the United States, France and Germany, the UK currently treats non-resident investors more favourably on exit than a UK tax resident; which provides another attraction for the international investor.

Business rates the stumbling block?

Business rates amount to 70 pence for every pound of corporation tax raised from every business in the country. A further 70 pence of every pound is raised from council tax. Arguably the high street is suffering because of business rates. However, given that it is such a huge source of income for the Government, what could replace it without a significant loss? The real estate industry needs to provide credible alternatives in this area, only then will its suggestions for amendments to the regime receive a sympathetic hearing in government circles.

In Conclusion

Business rates apart, good tax advice and careful structuring should ensure an acceptable level of tax leakage in relation to UK property acquisitions. Off-shore acquisition into the UK can eliminate capital gains for the international investor and offer the benefits of a benign regime.

Don't Let It All Go Wrong – Avoid Disputes

Tim Haynes, Senior Managing Director in the FTI Consulting Forensic and Litigation Consulting Practice discussed issues that may derail the construction process.

Tim has focused his career on procurement and dispute resolution in the construction industry. Avoiding disputes is important as they can be very costly and can therefore have a significant impact on your investment return.

It is therefore vital to get things right from inception and ensure that sufficient time is allocated to the design, construction, quality, cost and safety issues before work proceeds.

Disputes come in many guises and can be between stakeholders; contractors, sub-contractors, developers; designers and so on.

Over the last 60 years there have been a plethora of reports criticising the construction industry. The industry has been seen as fragmented and focused on individual interests. Sir Michael Latham however made a number of recommendations that have been adopted resulting in a diminishing number of construction disputes. Of those that do occur, they are often dealt with quickly and efficiently, reducing time and cost.

Causes of construction disputes?

There is often a failure to properly administer the contract. The Engineering and Construction Contract was intended to improve project administration, but this contract is not without its problems. Unless people are properly educated in its use then matters can soon escalate.

There is often a failure to understand contract clauses. For example the need to give timely notices, if not issued in accordance with the contract, can eliminate entitlement. Also employer changes can create problems for contractors and there can be conflicting party interests. In recent years contractors have bid for work at a zero or negative margin knowing that the only way to make money is to find fault during the construction process and claim accordingly. Such claims are almost inevitably inflated to make up margins. Incomplete and unsubstantiated claims are therefore an additional problem. In any dispute the question to ask is what was the actual cost and what is in the imagination of the contractor.

Considerations to avoid disputes

To avoid disputes early consideration and allocation of project risk is essential as is determining the right procurement strategy, for example, design and build, traditional or construction management. It is essential to maintain the line of communication and, if a claim should arise, be realistic in terms of the claim and calculation of its value. Approach situations with the appropriate attitude and commitment and avoid an adversarial position. Educate people properly and negotiate. Why negotiate? Because the only good construction dispute is the one that can be avoided.

Giles Barrie
+44 (0)20 7269 7284
giles.barrie@fticonsulting.com

Tim Haynes
+44 (0)20 7979 7454
tim.haynes@fticonsulting.com

Bas Kundu
+44 (0)20 7979 7506
bas.kundu@fticonsulting.com