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ArmstrongWatson®
Accountants, Business & Financial Advisers

Property Matters

The new specialist publication from the Property & Construction Team at Armstrong Watson

2016 AUTUMN STATEMENT

How it might affect you

BUY TO LET LANDLORDS

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NORTHWOOD CUMBRIA

Our Q&A with Managing Director Gordon Adamson

Author: Andrew Kennon

Welcome to Property Matters

Welcome to the first edition of our Property Matters newsletter, the specialist publication from the Property & Construction Team at Armstrong Watson.

The big news over the last few months has been Brexit followed by the outcome of the US Presidential election and the knock on effect we will see here in the UK. The truth of the situation is that the impact of these events is not yet clear, however, we have not seen any immediate signs to suggest that property or construction related transactions are falling over or stalling.

The Autumn Statement was perhaps not as jam packed with new and exciting headlines, however, there were some interesting announcements in the sector. In this edition, we highlight items such as the crack down on letting fees and the increased administration burden on landlords.

> "The big news over the last few months has been Brexit"

Also in this edition...

Autumn Statement

In the 2016 Autumn Statement, Chancellor Phillip Hammond announced a crack down on letting fees stating that they will be banned. Letting fees usually cover upfront costs that landlords face such as credit references, inventory checks and the drafting of tenancy agreements.

The Chancellor said that shifting the cost to landlords instead of tenants will save 4.3m households hundreds of pounds. However, many fear that the removal of upfront fees will cost the tenants in the long-run; landlords will need to recoup their costs through increased rents. When the restrictions to tax-relief on mortgage interest are introduced in April, many landlords will see a fall in their after tax profits, coupled with the increased burden of administration costs some landlords may well find themselves in a loss making position. This will be the latest in a growing list of attacks on the property sector.

In Scotland, letting agency fees to tenants have already been banned. However, studies do show that since the ban in Scotland, any rent increases were 'small and short-lived' despite expectation.

The extent of the ban remains to be seen; what it covers and how it will be imposed will need careful consideration. The government plans to consult on this in due course.

However, that wasn't the only announcement to impact on the housing market. In many ways it's just as important to note what he didn't say:

- One big disappointment was the silence on Stamp Duty Land Tax reform. The stamp duty surcharge seems set to continue; hampering transactions across the housing market and sending out completely the wrong signal to investors.
- The Chancellor did not make reference to any buy-to-let reforms, however he has announced there will be a focused review of incorporations. This could impact on landlords who have incorporated to avoid the changes to tax relief on mortgage interest. Once we know more detail we will be able to assess any impact.
- Mr Hammond referred to 'urgent challenges' facing the housing sector and there will be a White Paper designated to address these issues.
- Infrastructure was indeed a buzzword of the statement; the £2.3bn Housing Infrastructure Fund announced to deliver infrastructure for up to 100,000 new homes in areas of high demand, as well as £1.4bn to fund an extra 40,000 affordable homes. This is in addition to the £3bn Home Building Fund announced at the beginning of last month. The property industry will benefit hugely from the spending on infrastructure to help bring forward housing sites. Investment in infrastructure is a good thing in itself, but it has a further positive impact on the market as it is more likely to attract investment from developers; new houses in places where there are good transport links and digital networks.

We welcome any initiatives that help increase the delivery of new homes but it is vital that these measures filter through quickly and are transparent so that the industry can take advantage of what is offered and they will readily translate into more homes becoming available to those that need them.

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NORTH ASSOCIATES

North Associates

The fear and uncertainty created immediately post Brexit appears to have subsided within the property sector as market confidence continues to be restored.

Following the outcome of the EU referendum share prices of the major house builders plunged as much as 40 percent with the larger developers of commercial projects in the UK also following this trend. Standard Life, Aviva and M&G all suspended UK commercial property investment funds over concerns about liquidity, fearing investors pull out over the Brexit result. The number of house sales also fell sharply in the months following the vote to leave with price falls calculated around 3% in the north west of the country.

Liaison with house builders over on-going transactions as well as option negotiations certainly stoked this concern within North Associates with many developers threatening to pull progressing deals and even withdraw from marginal locations. It was very difficult to gauge whether this was a likely threat or bluster to drive down the purchase price at a time of uncertainty. Reviewing now, we are of the opinion that these threats were real with even the national developers caught up in the uncertainty and apprehension created by the vote to leave.

The loss in confidence was echoed in the housing market with first-time buyers and landlords deciding to wait to see if these initial falls following the outcome were a sign of more to come. Perhaps of greater concern was data released by the Bank of England which showed mortgage approvals dropped sharply from 64,200 loans in June to 60,900 in July following the referendum vote.

However, there are now clear signs that the property market is settling down after the initial surprise of the outcome to the EU referendum. Latest figures from the RICS showed agents now expecting house prices to rise 3.3% a year over the next five year period. This remains lower than pre-referendum forecasts but far from the predictions that the property market would be sent tumbling immediately following the outcome of the vote on the 24th June.

The sustained low interest rate remains a positive for property developers, funders and (crucially) purchasers. This has been set against a background of low inflation, however inflationary pressures are now on the rise, principally as a result of the Pound's reduced value relative to other currencies following the Brexit vote. The Bank of England has suggested that inflation will rise as the cost of imported goods and services increases over the next 'few years', as the economy adjusts to the weaker Pound (witness Tesco and Unilever's recent dispute over the price of imported foodstuffs). America's Federal Reserve is signalling a possible interest rate rise, which would further strengthen the Dollar against the Pound. One thing is for sure – interest rates cannot get much lower; the longer term outlook is perhaps less clear than it has been over recent years.

The uncertainties faced by the house builders appear to be short lived, with Persimmon announcing an increase of its annual profits by 19%. As a company we have also experienced this return in confidence, concluding a number of sales on major sites and negotiating successfully on behalf of the landowner an uplift in the purchase price of Option Agreements. Analysing the house builder's development appraisals there has been no amendments to their sales rates of revenue calculations pre the June referendum, again suggesting a blip in confidence.

We are yet to see the impact on the planning system, with the majority of the planning regulations intertwined with European law, particularly regarding environmental considerations. The full scale and implications will continue to be seen over the coming months and years with fluctuations in the property market to continue as the strategy for departure is unveiled, however we suspect that fears of a repeat recession are overdone.

There are now clear signs that the property market is settling down after the initial surprise of the outcome to the EU referendum

North Associates would be happy to discuss your property requirements further and advise on how best to respond and adapt to changing circumstances.

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Author: Clive Briggs

Construction funding

Businesses in the construction sector have been hit the hardest of any UK sector by longer waits for their invoices to be paid. Delays have increased 22 per cent in the last year, from 67 days to 82 days.

The Asset Based Finance Association (ABFA) says UK businesses now face an average wait of 61 days; just a 2 per cent increase from 60 days last year, putting into perspective the problems facing construction in regard to late payment.

ABFA says that slow payment of bills is a major reason why the construction sector has such a high number of insolvencies. Last year 17 per cent of all corporate insolvencies were businesses in the construction sector.

Jeff Longhurst, chief executive of ABFA, says that the sector has a real problem getting clients to pay on time and the huge number of construction companies that became insolvent last year only goes to show how bad the problem is.

'Long supply chains in industries like construction mean that the ripple effect of delays is likely to affect many other businesses further down, with SMEs hit the hardest. In an industry with high overheads in terms of materials and labour costs, this can be difficult to deal with,' he adds.

So, how can the industry tackle these issues and ensure that contractors continue to get paid?

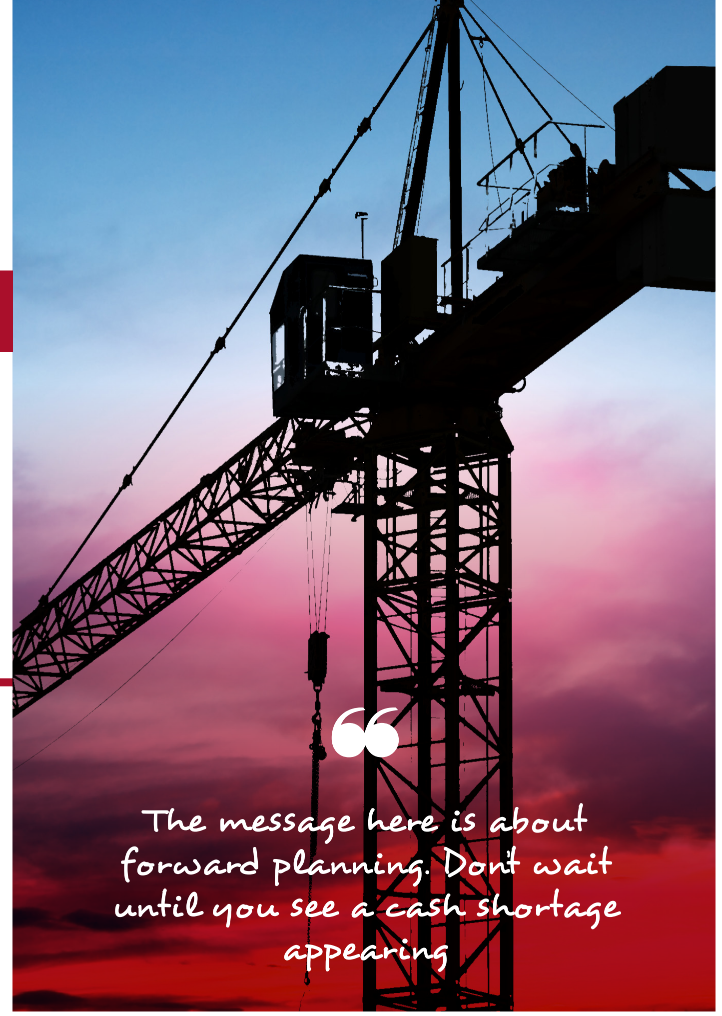
The Construction Act was brought in to ensure that payments are made promptly throughout the supply chain and disputes resolved quickly, however this isn't being adhered to in many scenarios.

Smaller sub-contractors are now turning to funders to bridge that gap as they have wages and suppliers to pay and can't rely on timely payments from main contractors.

Terms are being stretched from 30 days to 90 days and this causes cash flow issues for many smaller businesses who do not have cash resources to fall back on.

Fortunately, the number of independent lenders prepared to provide funding for the sector has increased quite dramatically in recent years so we can find a solution to most problems.

The key is making sure that you have funding options available as early on in the process as possible. Most funders are prepared to undertake a process which enables them to make a firm offer of facilities with minimal cost to the client; thereby giving peace of mind should cash be needed. The very worst scenario would be to wait until you see a problem with the cash flow and reacting accordingly. By then your options will be limited and many funders will regard any funding as a temporary solution rather than a tailored facility. Of course there will always be the unexpected blips but short term fixes are available.



Options include funding for specific, or even single, invoices rather than the full ledger. This can be done via a number of online funders, but they will require verification that the work relating to that application/stage payment has been completed. This is often done by a call or email exchange with the contractor's QS and sight of any paperwork relating to the job.

For a longer term solution, funding whole ledgers is now more commonplace and provides a consistent flow of cash to the business, particularly those on longer contracts who know they can draw on 50-70% of raised applications on an ongoing basis. This enables them to pay their staff on a timely basis and maintain a good credit record with their suppliers.

There are also funders who will provide short term funding based on the strength of a balance sheet or the Directors personal worth.

Overall the message here is about forward planning. Don't wait until you see a cash shortage appearing. Expect your invoices to be paid late and expect your suppliers and contractors to require payment on time.

Most facilities will only charge you for the amount of money borrowed. Get facilities agreed in principle so you can move quickly when the business requires it.


Author:
Susan Winter

Buy-to-let landlords
– it's time for a review

As a landlord the most likely reason you own a buy to let property is either to obtain a good yield on the property or to be relatively cash-neutral each year whilst achieving capital growth. The Government's objective of making the tax system fairer has impacted on residential landlords and inevitably impacted on the return achieved as well as changing the way capital growth is taxed.

Significant changes announced in recent Budgets have covered purchases, sales and ongoing ownership of residential properties and have included:

- 8% surcharge on Capital Gains Tax rate when selling;
- 3% surcharge on Stamp Duty Land Tax when buying;
- Removal of the 10% wear and tear allowance;
- A basic rate tax restriction of mortgage interest relief claimed;

In this article we're focusing on the change to the mortgage interest relief which was announced by the Chancellor in the summer budget of 2015. At that time, and to allow you enough time to prepare, the implementation of the changes was delayed until 6 April 2017 with phasing in so that the full impact wasn't felt until 6 April 2020 (see table below). With April 2017 on the horizon now really is the time to consider what action is needed if you haven't already done so.

Tax Year	Deducted from profits	Restricted to basic rate reduction
2017/18	75%	25%
2018/19	50%	50%
2019/20	25%	75%
2020/21	0%	100%

It is worth pointing out that this restriction is applied to all 'finance costs'. The definition of this doesn't just include the anticipated mortgage interest but also covers payments equivalent to mortgage interest and incidental costs of financing. The relief also applies to borrowing for residential properties located outside the UK.

Currently, finance costs are deductible from rental profits if the purpose of the borrowing is to acquire the related property. We belief that this is also now being investigated such that in future borrowing may need to be more closely tied to the property itself, e.g. secured on the rental property. That could end the practice of borrowing against the family home at a lower interest rate to invest in a buy to let. Watch this space for future developments in this area.

You may be reading this article safe in the knowledge that as you're not a higher rate taxpayer the changes will not affect you. Think again. The changes could affect all taxpayers, although when we make this reference we are referring to individuals only, so not companies or those dealing in property development, commercial letting or furnished holiday letting.

We will not bore you with the reasons why the change could affect you as a non-higher rate taxpayer other than to say it is related to the mechanics of the tax calculation. Some of the ways in which you may see this relief impact upon you and which are linked to changes in your 'taxable income' figure are as follows:

- You may become a higher rate (or additional rate) taxpayer;
- Entitlement to Tax Credits may be reduced;
- Payment of a High Interest Child Benefit Charge may be due;
- Student Loan repayments may become due or be increased;

So, If you haven't already done so, now is the time to take a step back and review your buy to let investments. Every individual really is different in the way that this rule change will affect them. A detailed calculation based on your particular circumstances is the only way to make an informed decision and allow you to consider the options available to you such as incorporation, change of ownership or disposal of the property.

Author: Victoria Lawson

Principal Private Residence Relief

Relief from Capital Gains Tax is available on a gain arising on the disposal of property that has, throughout the period of ownership, been the individual's only or main residence.

If the property has not been occupied as such throughout the entire period of ownership then the last 18 months of ownership will automatically qualify for relief, along with the period the property was actually occupied. In addition, a former main residence that has been let for a period can benefit from letting relief which can exempt gains of up to £40,000 per person.

What is perhaps less well known is the ability to make a main residence nomination or election where individuals have more than one home. This did become the subject of much controversy, a few years back, when the 'scandal' of MPs nominating their second home in London to be their main home for private residence relief was hot in the press. As London property prices are generally higher than elsewhere in the country, the exemption can often be put to best use against such a property. Although there was outrage at the time, the ability to choose which residence qualifies as the main residence for exemption is specifically provided for within the tax legislation and continues to be available to all taxpayers.

Before a property can be nominated as a main residence, it has to be used as a residence. This prevents a person from nominating an investment property, never used as a residence, such as a buy-to-let. HMRC accept that you can have more than one residence, however, you can only have one main residence which qualifies for exemption at any one time. The main residence does not have to be the property in which you spend the most time or indeed the larger of the two properties.

If you acquire a second home you can notify HMRC, within two years, which one is to be exempt for Capital Gains Tax purposes. If no election is made they will decide, based on the facts, which one is the main residence and this may not necessarily be in your favour. If only one residence is owned there is no need to make any nomination as the relief on that property will be given automatically.

> *"Private residence relief is a very valuable exemption"*

This issue also crops up when couples marry or register as civil partners with each party already owning their own home; in this context, married couples get something of a raw deal. A husband and wife or civil partners are only allowed one main residence between them and it is not therefore possible for them to each have a separate property as their main residence. Un-married partners do have this option.

If a couple own properties prior to their official union they need to make an election to nominate one as their main residence within two years of the marriage/registration. The property which is nominated will continue to benefit from the exemption. Although the exemption for the other property will then cease it will still benefit from the relief up to the date of the nomination and, as noted above, the last 18 months of ownership will in any case be automatically exempt.

A further benefit of making the election is that once made it can be varied, at any time, to notify a change of qualifying property. There are potential Capital Gains Tax planning opportunities around this ability to change the election, but care is needed. You obviously cannot nominate a property that you have never used as a home.

If you have missed the two year deadline for making the nomination it can still be possible to find a further opportunity to make the election. A second property which is let for a period of time and then becomes available for use as a second home will, potentially, start a new two year period to make the election, for example.

Private residence relief is a very valuable exemption, particularly when combined with the 'final 18 months of ownership rule', letting relief and the second property nomination. Taxpayers with multiple residences should review their portfolio on a regular basis and ensure that the private residence relief is put to best use and where necessary change the nominated property to achieve this.

Author:
Gordon Adamson

Q&A Northwood Cumbria

1. What are the current key issues and risks you see facing residential property landlords?

Nothing affects the lettings market as much as uncertainty. The effect of the changes to Section 24 of the Finance Act (tax relief on finance costs) has created just this and resulted in a state of inertia as landlords consider their positions. This is both in terms of portfolio growth and disposal. Tenants are aware of the news regarding tenant fees and many believe this has already happened, however this may result in reduced tenant mobility until the legislation is in place. Regulatory burdens increase by the week and tenants are increasingly well informed about their rights.

2. Where do you see the residential lettings market in the next two to three years?

We believe that there will be a small increase in rents as costs may well be passed on to tenants, however with demand such as it is coupled with the difficulty in getting on the property market, we believe the rental market will remain strong and demand will surpass supply.

3. How do you think the changes to mortgage interest tax relief will impact on the market going forward?

There is no doubt the changes to the way landlords are taxed will have an impact on landlords in the short term, however we believe the market will adjust. Whilst profit and yield will feel a negative impact, long term capital growth will still outweigh the benefits keeping your money in a savings account. The additional stamp duty land tax burden is but an upfront payment which can be offset against the capital gain on the sale of the property. Investment in buy to let remains one of the best long term investments and is one of the very few which can be leveraged.

4. What are the key advantages to the guaranteed rent scheme?

Our Guaranteed Rent scheme differs from insurance backed schemes of the same name. We do not have the excess and limits associated with an insurance policy and we include legal costs, non-payment by the tenant and void periods. We effectively become your tenant and give you peace of mind by fully managing your property as well. It's the perfect, risk free service for landlords and most are better off financially with us as opposed to using a traditional managed service after the commissions, charges and of course VAT have been deducted.

5. What are your top five tips for residential property landlords?

i. Use a properly regulated & qualified agent. With the increasingly complex regulations you need an agent who is compliant and properly insured. NALS, ARLA, NAEA & RICS agents are properly regulated. If an agent isn't part of such an organisation, you should ask 'why?'.

ii. Look after your tenants and know your legal obligations. Happy tenants are most likely to be good tenants. They pay a lot of rent and expect a professional service.

iii. Choose a professional agent you feel you can work with and who understands your market. Do not be swayed by cheap fees as seldom will you save in the long run.

iv. Invest in a professional inventory, not just a list of contents and ensure that your tenant agrees the schedule of condition.

v. Deal with maintenance issues as quickly as possible. Nothing affects the landlord / tenant relationship more adversely than landlords failing to make repairs and this can even effect your ability to regain possession of a property under section 21 of 1988 Housing Act.

Author:
Susan Winter

Student Accommodation

What's the solution?

All too soon our children become teenagers and University is looming before you know it.

This can be an expensive time and inevitably parents will be called on to help.

One of the main problems is the funding of accommodation. Housing is expensive as we all know but renting a property may not be the best long-term use of the money. Students are unlikely to be in a position to buy property themselves so it is left to the parents to consider what to do and how to do it.

Parents might consider contributing the deposit for their child to buy a property which they would then occupy and also rent out, in part, to fellow students. The parents would obviously have to guarantee the mortgage as no lender is going to risk making loans to a group of impoverished students without that comfort.

There are however some practical problems:

- Many parents would be uncomfortable with such a valuable asset being owned outright by someone in their late teens or early twenties.
- There may be other younger brothers or sisters hoping to go to university later on and funding an arrangement like this for all of them might be out of the question.
- Many lenders don't like it. Frequently banks or building societies prefer to have the property in the names of the parents rather than use some form of a guarantee.

An alternative might be for the parents to own the property and pay the mortgage in the normal way. When it is no longer needed it could be sold with the sale proceeds returning to the parents. They could then, if they wish, use the funds for other children in the same way.

Problem solved?

Well no. One of the main attractions of buying a property like this is to benefit from an anticipated increase in property values. Any such increase would be subject to Capital Gains Tax (CGT) on sale. The exemption widely used for houses will not apply for a property which is not the main residence of the owner.

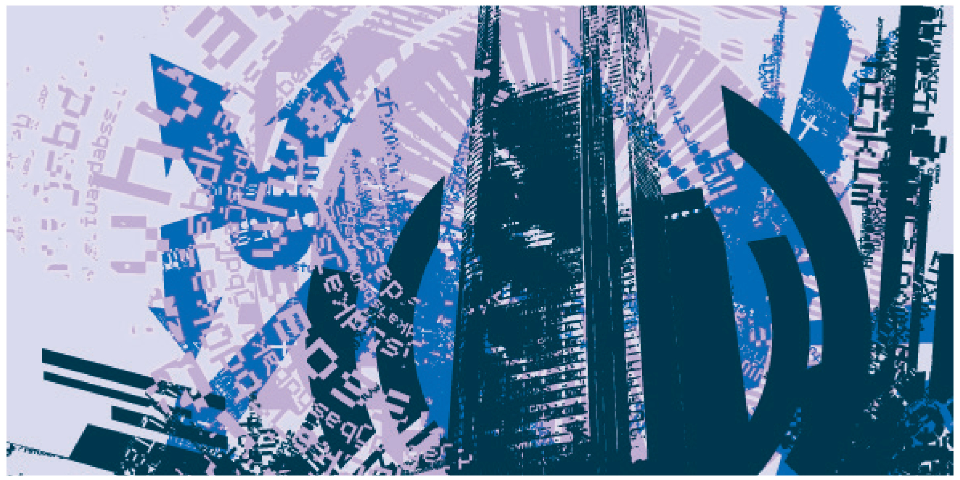
So what is the solution?

It is possible to structure the purchase in a more tax efficient manner such that the eventual sale of the property will be free from Capital Gains Tax. Furthermore the property could be held as an investment for a number of years after and with the benefit of lettings relief the property could remain free from Capital Gains Tax.

The trick is to use a suitably worded trust deed for the property which enables all of the parents' objectives to be met, creating security for the parents' investment and avoiding a potential 28% Tax liability.

The property can still be legally owned by the parents satisfying the mortgage lender. The property can still be sublet to other students. The parents can decide when or if the property is sold. They can also decide whether the same funds or even the same property is used for other children.

If you have student children and are thinking of buying or funding accommodation you should certainly look at this option.



VAT

re conversion of non-residential accommodation

Converting non-residential property into dwellings – What about VAT?

If you are a developer involved in the conversion of non-residential property into dwellings, then it is vital to understand the VAT rules around this area. There is often the potential for VAT savings to be obtained.

The first thing that should be considered is whether or not an option to tax has been exercised on the building by the seller. If so, they will be looking to charge VAT on the sale.

To avoid VAT being applied to your purchase, you can issue a VAT 1614D form advising them of your intention to convert the property into dwellings.

By issuing this form you dis-apply the seller's option to tax and change the supply from being standard rated for VAT to exempt from VAT. This is of particular benefit where VAT cannot be recovered on the development.

The 1614D form must be issued to the seller prior to exchange of contracts. If received later than this, it is then at the discretion of the seller whether or not to accept it.

It is possible that the seller could refuse to accept the form even if issued on time, especially if the property is subject to the capital goods scheme adjustments.

HMRC have however confirmed that as long as the form is issued on time, it must be accepted by the seller if the sale goes ahead.

A further benefit from issuing the 1614D form and avoiding VAT being charged on the transaction is that the Stamp Duty Land Tax (SDLT) payable will be less. SDLT is calculated on the VAT inclusive price, so if there is no VAT chargeable on the transaction, consequently any SDLT due will be reduced.

Once a non-residential property has been purchased and the work commences to convert it into dwellings many of the services provided to you by contractors should attract VAT at the reduced rate of 5%, rather than at the standard rate of 20%.

This reduced rate will also apply to any materials that the contractors supply alongside their services, however any materials purchased separately would attract VAT at the standard rate.

If the intention is to sell the converted properties on completion of the works, then the VAT liability of the sale will be zero rated. What this means, is that although no VAT needed to be charged on the sale of the property, the supply is still treated as being a taxable supply, therefore allowing you to register for VAT and recover input VAT incurred on the development.

An issue that arises is when rather than sell the property, you instead opt to rent it out. Residential rental income is always exempt from VAT, meaning that input VAT associated with the development cannot be recovered.

A potential planning opportunity which could be considered here would be to sell the converted property to a connected entity. This sale would be zero rated for VAT, allowing recovery of the input VAT.

The connected entity would then rent the properties exempt from VAT, but would not usually have any significant input VAT to claim. The inability to recover the input VAT would then no longer be a major issue.

Such planning does need careful consideration including reviewing the impact on any other taxes, but where property is concerned, VAT should always be an area that is considered in detail.

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