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July 2021

Proposed HM Treasury Residential Property Developer Tax

IPF Survey of large-scale participants in the residential investment market

1. Executive Summary

- In April 2021, HM Treasury released a consultation paper outlining a proposed Residential Property Developer Tax (RPDT).

- The proposal envisages a tax on the profits of larger-scale entities developing UK housing that will be used to help fund government grants to long leaseholders of properties affected by the cladding safety issues, brought to light by the Grenfell Tower tragedy.

- The level of tax is still to be determined but the Government's aim is to raise at least £2 billion over the next decade.

- The IPF released a short survey to quantify objectively the impact of the proposed RPDT on the likely impact on residential investment appetite and intentions of large-scale institutions.

- It utilised its network of large-scale institutional investor contacts, to distribute the survey, obtained through publishing the annual 'UK Residential Property: Institutional Attitudes and Investment Survey' for the last nine years. These include life assurance companies, property companies, fund and investment managers and developers.

- There were 28 respondents to the survey. They own over £25 billion of UK residential assets, including Build to Rent (BTR) and purpose-built student accommodation, and intend to invest almost £13.9 billion over the next three years.

- Three-quarters of contributors (21 out of 28) stated that their investment plans would be impacted by the introduction of the tax, with 16 proposing that the tax will have significant implications for the residential market.

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- One-quarter of respondents (7 out of 28) stated that the proposed tax would have no impact on their residential investment plans, as they are not contemplating residential development or they believe they are not in the scope of the tax.

- Over 60% (13 out of 21) of contributors, changing their investment programmes with the introduction of the RPDT, would reduce their exposure to residential. One stated they would stop investing in the sector altogether.

- Seven respondents out of the 21 would adjust their investment approach, rather than decreasing their exposure, including changing the type of residential asset acquired or reducing the percentage of affordable housing on sites, to improve viability.

- Of the 28 surveyed, nine contributors have, or have had, exposure to properties with ACM or other cladding deemed unsafe. Removal of cladding has already been completed or is in the process of being removed.

- Only two of these contributors are eligible for government assistance and then only for a negligible part of their overall residential holdings. One stated that this was on legacy assets and not on their core BTR business.

- Only five respondents (18%) stated that their response to the proposed tax charge would be different if it was introduced at a later date.

- Investors state that they cannot rigorously evaluate the impact of the tax due to a lack of details in the consultation, particularly the rate of tax and who will be in scope.

- Particular concern was expressed by contributors that the RPDT would disadvantage BTR compared to Build to Sell (BTS). The main reasons for this are:
    - The nature of the mechanism by which the tax will be calculated. BTS developers can pay a higher rate of tax on profits, whereas BTR will have to pay a tax on a notional and unrealised investment gain; and
    - BTR is already responsible for rectifying cladding issues on its own properties.

- There is nervousness that the tax will dampen demand from large-scale institutional investors, particularly from overseas, at a point in time where the immature BTR market is benefitting from large scale, modern development that these investors finance.

- There is concern that HM Treasury has used a complex approach to raise the necessary funds, with the introduction of a new tax, and simpler methods should be explored.

2. Introduction

In April 2021, HM Treasury published a consultation paper outlining a proposed Residential Property Developer Tax (RPDT). The proposal envisages a tax on the profits of larger-scale companies and groups developing UK housing (the definition of which currently includes Build to Rent (BTR), affordable housing, purpose-built student accommodation (PBSA) and retirement communities) that will be used to help fund government grants to long leaseholders of properties affected by the cladding safety issues, brought to light by the Grenfell Tower tragedy. The level of this tax is still to be determined but the aim is to raise at least £2 billion over the next decade. The RPDT proposals suggest a tax on realised or unrealised profit from residential development activity and outline several options around mechanics and calculation.

To quantify objectively the impact of the proposed RPDT on residential investment appetite and intentions, the IPF has canvased key large-scale participants in the residential investment market, via a short survey. The IPF has published the annual 'UK Residential Property: Institutional Attitudes and Investment Survey' for the past nine years and invited approximately 60 key organisations, in the BTR and PBSA markets, to participate in the consultation, representing a range of real estate investors, including life assurance companies, property companies (including real estate investment trusts), fund and investment managers and developers.

The survey was carried out over a short period of time (just over three weeks) and a total of 28 responses were collected. Twenty-three of these 28 respondents contributed to the main 2020 IPF Residential Survey, representing 48% in terms of number of contributors and 53% of the assets under management covered by that publication.

The headline total value of global assets held or managed by the 28 respondents to this tax survey is £6.3 trillion, indicating the large institutional nature of the investors. UK real estate accounts for approximately £140 billion of their assets under management. One contributor did not provide details of current investments. The 27 respondents, who provided data on current assets under management, owned over £25 billion of residential assets.

In addition to the survey responses, two emails were received from organisations stating that they were already responding to the consultation through other avenues.

NOTE: The survey questions are included in an Appendix to this report.

3. Survey Findings

3.1 Profile of Contributors' UK Residential Investment

To provide an indication of the type and quantum of UK residential held by contributors, they were invited to provide details of which residential asset types they have exposure to. Five categories of assets were defined:

- Standing investment (market rent – PRS);
- Standing investment (sub-market rent/affordable – Social Housing);
- Development land for investment;
- Development land for market sales; and
- Other.

The results are shown in Table 3.1. The 27 respondents, who provided data on current assets under management, owned over £25 billion of residential assets. The most popular type of residential was PRS, accounting for 44% of all assets. Exposure to the 'Other' category, consisting predominantly of PBSA, totalled 24%, while Development for Rental Purposes and Development for Sale accounted for a further 14% and 8% respectively.

Table 3.1: All Contributors by Residential Asset Type (£million)

All Residential	PRS	Sub-Market Rent	Development for Rent	Development for Sale	Other
25,338 (100%)	11,104 (44%)	2,501 (10%)	3,604 (14%)	2,114 (8%)	6,015 (24%)

Note: Estimates at June 2021

Contributors were also questioned over their investment intentions towards the UK residential sector and provided details of the type of property and approximate amount expected to be invested or disinvested over the next three years. The responses of 28 investors are summarised in Table 3.2. Net investment intentions towards residential amount to almost £13.9 billion, with Development for Rental Purposes being the most popular, accounting for 44% of intended investment.

Table 3.2: Investor Intentions over the next three years

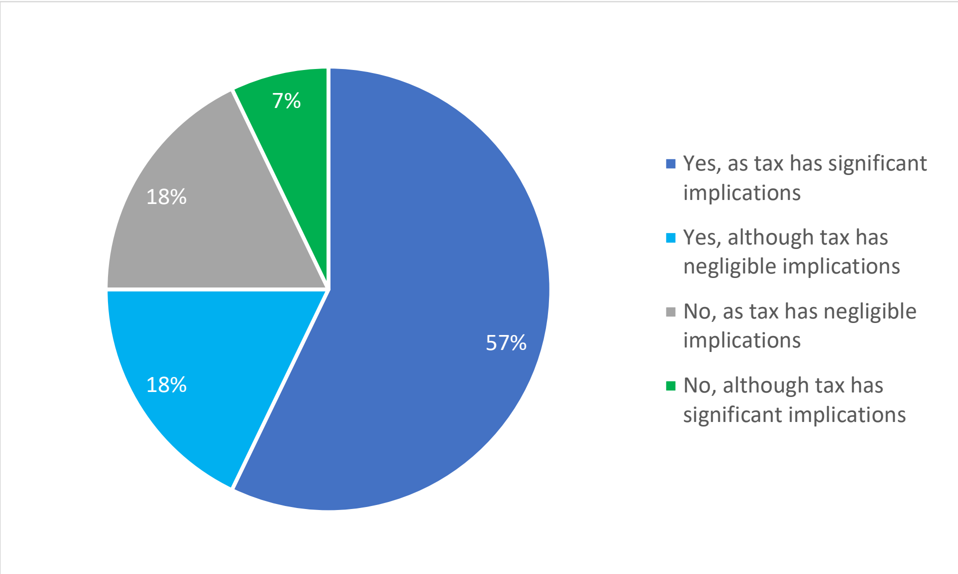
	PRS	Sub-Market	Devt. Rent	Devt. Sales	Other	Total
Invest (£m)	5,466	1,741	6,148	1,820	450	15,626
No.	13	11	12	4	2	42
Disinvest (£m)	100	0	0	1,629	0	1,729
No.	1	0	0	2	0	3
Net Invest (£m)	**5,366**	**1,741**	**6,148**	**191**	**450**	**13,897**
No. Net Investors	**13**	**11**	**12**	**3**	**2**	**41**

Note: A number of investors expressed intentions to invest/or disinvest in more than one type of residential asset.

3.2 Potential Impact on Investment Plans

The 28 respondents were asked if they would adjust their development plans, build-out strategy, or land acquisition strategy in response to the implementation of the proposed developer tax. The results are displayed in Figure 3.1.

Figure 3.1: Changes to investment intentions



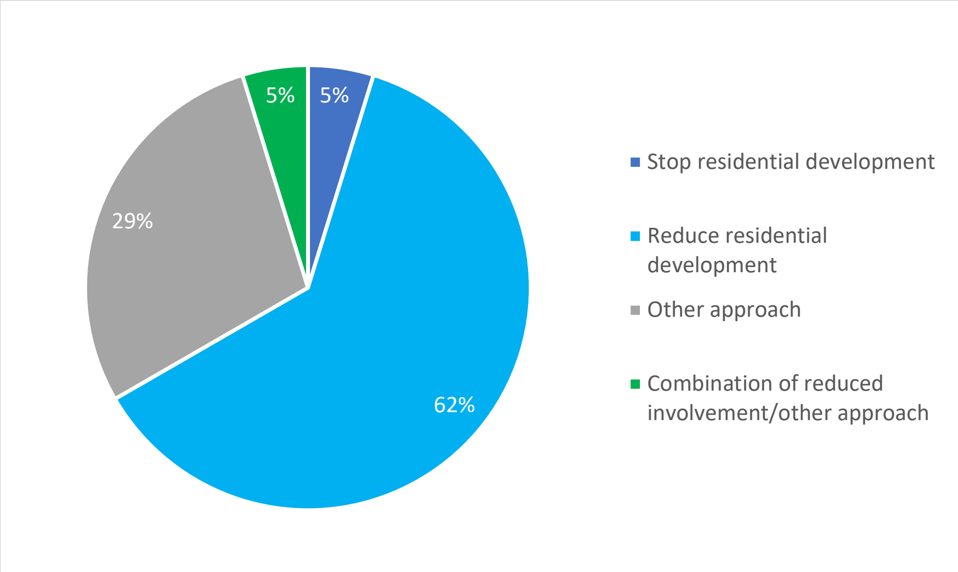
Note: The results are for all 28 contributors to the survey

As shown in Figure 3.1, a quarter of the respondents (7) stated that the proposed tax will have no impact on their residential investment programme. This was because as they have no plans to develop residential or they believe they will not be in scope to pay the tax. One contributor commented that, "if the scope is expanded to include rental and capital growth outside of the development process (even if within the development period) then we would have to reconsider our appetite for the investment sector. Even if the economic burden of the tax is negligible the potential of increased reporting could be a deterrent for investment".

Three-quarters of the contributors (21), who are developing, or will considered residential development in the future, stated that their investment plans would be impacted by the introduction of the tax, with 16 believing that the tax will have significant implications. The other five stated that they will consider changing their plans, regardless of the level of tax.

The 21 respondents, who stated that their residential investment plans will be impacted by the proposed tax, were probed over how they intend to adjust their programmes. The results are displayed in Figure 3.2. Only one stated that they would stop residential development investment altogether as the sector, in their view, would not be attractive compared to other parts of the market, given its immaturity and reliance on future development.

Figure 3.2: Potential change to investment plans due to proposed tax



Note: The results are for the 21 respondents who intend to change their investment intentions if tax is implemented.

Thirteen respondents (62%) stated that they will reduce their exposure to residential if the RPDT is implemented. Of those qualifying the reason for this approach, six commented that this reduction would be driven by a decline in investor appetite as a result of the perceived negative impact of the tax and, in particular, from global investors who have an array of investment options at their disposal. Three investors expressed concern about the viability of developments given that target total returns will remain the same. This will cause difficulty in sourcing assets in a market where profit margins are already thin.

Six investors noted that they will change their investment approach to residential if the tax is introduced, rather than reduce or stop investing, with three explaining that they would change the type of residential they acquire. One contributor stated that their response would be a combination of reduced involvement and an alternative approach, namely to reduce the percentage of affordable housing on sites to improve viability.

There was no marked difference in the responses from investors with exposure to the different types of residential, i.e., from BTR or PBSA.

The survey responses imply that a percentage of the £13.9 billion investment (See Section 3.1) intended to be deployed into the residential development market, over the next three years, is at risk. Development is of particular importance to the UK residential market as it is an immature investment market (See 'Large-Scale UK Residential Investment Achieving Market Maturity' Short Paper, published by the IPF Research Programme in March 2021). Most institutional investors require large-scale, modern assets and there is currently a significant shortage of appropriate standing investment stock in the UK.

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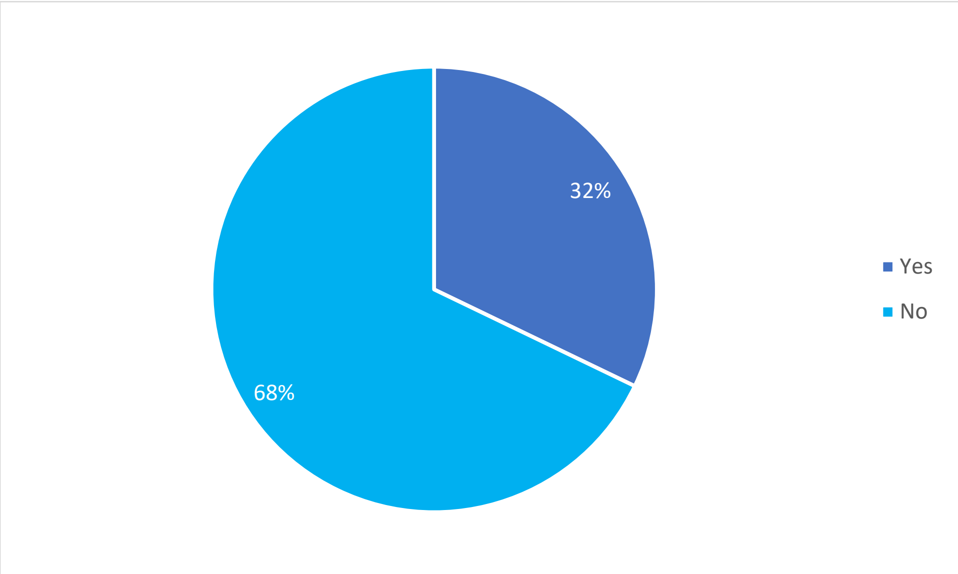
3.3 Cladding

Respondents were asked if they own or have developed any residential accommodation with aluminium composite material cladding (ACM) or any other cladding that has since been deemed unsafe. Nine (32%) of the 28 respondents had exposure to unsafe cladding and 19 had no exposure (see Figure 3.3).

Figure 3.3: Does your organisation have exposure to ACM or Other Unsafe Cladding?



Note: The results are for all 28 contributors to the survey

The nine investors, with cladding concerns, have already completed rectification work at their or another organisation's expense, or are in the process of doing so.

Contributors were asked, if they would qualify for any of the remediation funding proposed by the government, if there are any current or subsequent problems with the cladding of a building in their ownership. Only two stated that they are eligible for some assistance, with one explaining that this was only for a small number of legacy assets and not for their core BTR business.

3.4 Timing of Tax Implementation

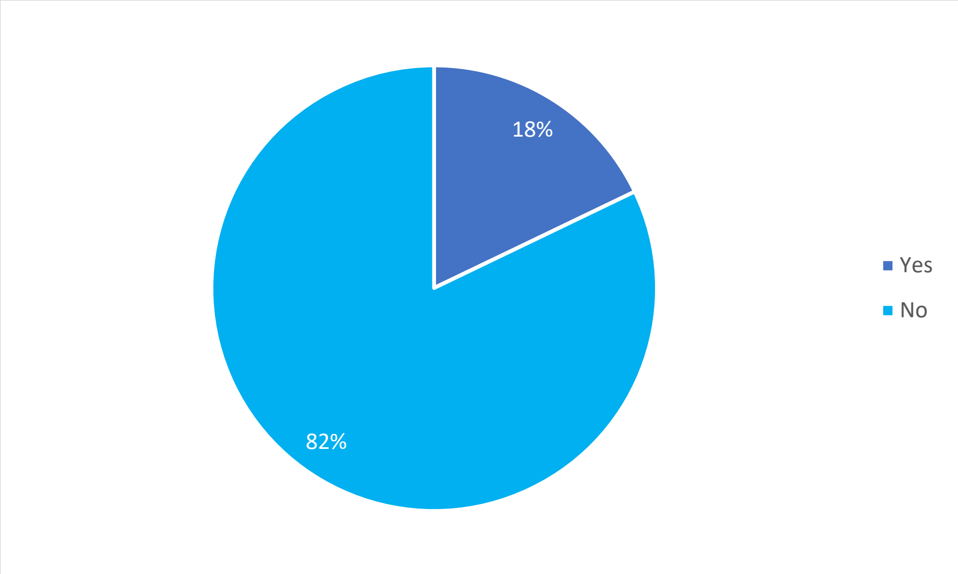
The proposed tax is due to be implemented in April 2022. Contributors were asked if their response to the proposed tax charge would be different if it was introduced at a later date.

Five investors (18%) stated that they would change their response, under these circumstances (see Figure 3.4). The reasons given were:

- It would allow more time to secure additional projects before the implementation date;
- It would allow more time to understand the implications and suitably price-in the tax into transactions to assess viability; and

- The tax will impact on existing investor returns whereas investors would be more aware of the tax impact if it were introduced at a later date, e.g., in four years' time, after the initial project development cycle.

Figure 3.4: Does the timing of the tax impact your organisation's response?



Note: The results are for all 28 contributors to the survey

3.5 Further Information Required from Consultation

Respondents were asked if there is any additional information required, from HM Treasury, to help inform their views on the proposed tax. There were a number of comments relating to the lack of detail in the proposed consultation. Further clarity is requested on the following:

- The rate of tax;
- Who is in scope to be taxed – developer/main contractor, forward funder, fund, underlying fund investor;
- The size of business in scope;
- How the tax will work on forward funding arrangements;
- How the tax will be applied to BTR investments that are in the process of being built and may complete after April 2022;
- Why interest deductions are not permitted i.e. tax should be on the net asset value; and
- Which of the two models will be used for the amount subject to tax.

3.5 Additional Comments

All respondents to the survey were invited to provide any additional comments that they may have, relating to the developer tax. These comments have been grouped and are listed below.

BTR unfairly penalised through the charging mechanism, compared to BTS
"BTR, including institutionally-funded affordable housing, will be hit harder than BTS, given the design of the proposed tax. BTS will pay a higher rate of tax on profits, rather than having to pay a tax on notional and unrealised investment gains." *"It is seemingly not designed with investment businesses in mind and therefore the addition of BTR etc into scope seems like an after-thought based on an incorrect assumption of fairness. The BTR sector will almost certainly be disadvantaged by its inclusion in the tax, compared to BTS developers, who will simply pay a higher rate of tax on profits, rather than suddenly paying a tax on a notional and unrealised investment gain."*
BTR already responsible for cladding rectification and lacks the benefit of government support
"The application of the RPDT to BTR is contrary to the purpose of the legislation since all fire safety and other maintenance works must already be undertaken/paid for by the investor and are not passed on to customers." *"The BTR market has not benefitted from Government cladding support and is now sharing the cost, which is a double hit as there are remediation programmes that are being carried out and funded, now and in the future, by BTR investors (without Government support)."* *"Furthermore, BTR investors (unlike developer traders) are liable to repair their own defective cladding and fire safety issues and yet do not get the benefit of government funding to do so. Accordingly, it would be inequitable for them to pay twice."* *"This tax runs counter to the government's stated intention of increasing rental housing stock in the UK and for a relatively new (BTR) sector that hasn't benefitted from Government cladding support to be sharing the cost is a double hit as there are remediation programs that are being carried out and funded by BTR investors (without Government support) already and planned for the coming years as well."* *"In addition, it is clear that the BTR sector has not benefitted at all from the main market interventions referred to in the consultation (SDLT holiday and mortgage support), thus further proving that the initial concept was not to include investment businesses, and therefore their inclusion is totally unjustified and detrimental to the number of affordable and private homes that will be built by the sector."* *"The tax proposed should not be imposed on BTR and institutionally-funded affordable housing businesses. Both of these business models would have to fund the remedial action relating to ACM themselves."*

Tax will discourage large lot size investment, important for the immature BTR market *"The introduction of tax is counter to the government's stated intention of increasing rental housing stock. The market is immature market, so development is important and large lot sizes are desired by overseas investors."* *"The policy unfairly targets BTR as an industry, as typically schemes are constructed on a large scale to achieve operational efficiency, which inadvertently puts many small and medium-sized developers (not just the largest corporates, as the proposals suggest) into the eligibility criteria for the tax."* *"Overseas institutions are targeting the sector but need larger lot sizes which the market is already struggling to provide."*
Simpler ways to raise required funding *"But residential development already suffers SDLT, CIL, S106, Affordable Housing, VAT and corporation tax. Why not simply tweak an existing tax rather than add a new one?"* *"Given the level of public support for victims of the cladding crisis, the government could have swiftly implemented a compensation scheme funded from general taxation, and it is disappointing that they seem to have opted for such a cumbersome alternative."* *"Raising £200m pa through the proposed tax is an extremely complex proposition - more simple ways that impose the tax on those businesses that caused the problems would be a fairer approach."*
Implementation of proposed tax will add complexity and cost *"This looks like a difficult tax to administer which will add further burden to development businesses' tax reporting. Government should focus on making the tax system simpler for all."* *"The valuation/accounting determination for tax payment is significant and will have a call for additional equity funding regardless of when the asset is sold or refinanced, this will have an impact to both investor cashflow and returns, investors invest a fixed amount and receive repayment on disposal/refinance."*
Lack of detail in the consultation proposal makes quantification of impact difficult *"It is impossible to state the impact without understanding fully the proposed rates. The proposals as outlined do not give sufficient information to arrive at a view as to the impact."* *"Information about the tax is so light it is very difficult to assess any impact."* *"It is imperative to long term investment planning that the tax rate is known ahead of investments being made. To allow such planning in the interim, grandfathering should be introduced to existing projects, exempting them from the tax, even if this means that the end date for the tax is pushed out to a later date."*

Lack of accountability for regulators and cladding manufacturers *“The proposal does not take into account the failure of the building regulation regime and the duty of care of product manufacturers owed to the development industry. The Government should therefore be ensuring the building regulations regime is tightened and properly enforced. Manufacturers and regulators should also be sharing their "fair" share of the pain for past mistakes.”*
Reasons behind the tax implementation *“The residential property developer tax has been conceived as an equitable taxation instrument to enable UK Government to recover all, or an element of, its costs expended in funding remediation of cladding safety issues on behalf of leaseholders and registered providers, from parties who had a role in delivering these cladding safety issues over the years. Putting aside the question of how regulatory failure has contributed to the problem, there seems some balance in that proposition.* *However, the current proposal to include the UK’s emerging, but still nascent, build to rent sector in these proposals is an entirely inequitable proposition for several key reasons. Firstly, the build to rent sector is new to the UK and has only recently started to deliver homes – as such it has not been ‘part of the problem.’ Secondly where rental investors have been faced with an issue – in our case on acquiring completed buildings with isolated cladding safety issues that were actually delivered by UK Government agencies – they are often capped out in their ability to claim Government funding support to remediate because of having single ownership and being caught by state aid rules – limiting recovery to just over £300,000 in total. Finally, the build to rent sector is covering the cost of an issues directly and no costs are passed to its leaseholders – under a standard assured shorthold tenancy (AST) these are landlord, not tenant, costs. As such, not only did the build to rent sector not contribute to the problem, it does not benefit from Government funding support to remediate the problem. Accordingly, the build to rent sector should be explicitly excluded from these taxation proposals.”*
Improve planning and government funding regimes to offset tax ramifications *“Speeding up the planning system and government funding for the refurbishment of existing stock to meet new regulatory/consumer needs could be a way to offset concerns of a development hit caused by the proposed tax.”*
The tax will lead to lower housing delivery, penalising renters *“The tax will be deeply unfair for renters, who will pay through increased rents driven by a lack of supply.”*

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Acknowledgements

The IPF would like to thank all 28 participants in the survey for contributing data and opinions, including the following 24 organisations that consented to be named:

Aberdeen Standard Investments
AEGON Asset Management
AXA IM Real Assets
Barings
CBRE Global Investors
Delancey Real Estate Asset Management Ltd
DWS Group
Federated Hermes
Fidelity International Ltd
Fizzy Living
Hearthstone Investment Management Ltd
Invesco Real Estate
JP Morgan Asset Management
Legal & General Affordable Homes Limited
Legal & General IM Real Assets
Nuveen Real Estate
PLATFORM_
Quintain Ltd
Realstar Group
Savills Investment Management
The PRS REIT
UBS Asset Management
Unite Students
Watkin Jones Group

APPENDIX

Residential Property Developer Tax – IPF Survey questions[1]

1. ABOUT YOU AND YOUR ORGANISATION

To complete this survey, the IPF requests that you provide certain information to permit us to contact you should we need to clarify or follow up any of your responses, as well as being able to send a summary to findings. The information requested includes such details as your name, position/job title, organisation, email and phone number. All personal data obtained as a result of your participation in this survey will be held in accordance with the IPF Privacy Policy, which can be seen at www.ipf.org.uk/privacy-notice.html.

1. Please click here to confirm your authorisation of the IPF to retain this data solely for the purposes stated above. *

☐ Yes, I authorise use of my data

2. Please provide your contact details. All information provided will be treated in absolute confidence by the IPF and we confirm that all data analysed and published will be presented in aggregate form only. *

First Name ________ *

Last Name ________ *

Organisation ________ *

Position ________

Email address ________

3. What type of organisation do you represent? *

☐ Pension Fund

☐ Insurer

☐ Investment Manager

☐ Property Company - listed

☐ Property Company - unlisted

☐ Developer

☐ Other (please specify):

____

[1] Questions marked with an asterisk require an answer.

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4. Are you willing for your organisation to be acknowledged at the end of the published survey results? *

- [ ] Yes
- [ ] No

2. ABOUT YOUR REAL ESTATE INTERESTS

5. Did your organisation take part in the IPF UK Residential Property: Institutional Attitudes and Investment Intentions Survey 2020? *

- [ ] Yes
- [ ] No

6. Do you give consent for the IPF to use the information from the 2021 Residential survey for the purposes of this consultation survey? *

- [ ] Yes
- [ ] No

7. What is the approximate value of your organisation's total UK property holdings? Please insert numbers only. *

Value (£m)

8. What is the approximate value of your organisation's global investment portfolio (all asset classes)? Please insert numbers only. *

Value (£m)

9. Focussing only on those assets where the residential element makes up the largest proportion by capital value, what is the approximate value of all your UK residential holdings and what proportion do they make up of your UK property investment portfolio(s)? *

Value (£m) *

Proportion (%) *

10. What types of residential property are you invested in? Please select as many options as relevant, entering the percentage each represents of your total residential investment holding by value. *

Standing investment (market rent) %

Standing investment (sub-market rent/affordable) %

Development land for investment stock %

Development land for market sales %

Other (please specify below) %

Total: %

Other:

11. What is the geographic distribution of your residential investments? Please entering the percentage of your total residential investment holding per location by value. Note: individual entries should add up to 100%.

London: Zones 1 - 3 %

London: Zones 4 - 6 %

South East (incl. East Anglia) %

South West %

Wales %

Midlands %

North (incl. Yorkshire) %

North West %

Scotland %

Other (please specify below) %

Total: %

Other:

12. Please indicate if you have increased or decreased your residential investment and/or development holdings in the last 12 months:

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	Invest (£m)	Disinvest (£m)
Standing investment (market rent)		
Standing investment (sub-market/affordable)		
Development land for investment stock		
Development land for market sales		
Other (please specify below):		

Other: by type(s) and approximate amounts if more than one

13. Please indicate if you are currently planning to increase or decrease your residential investment and/or development holdings in the next three years?:

	Invest (£m)	Disinvest (£m)
Standing investment (market rent)		
Standing investment (sub-market/affordable)		
Development land for investment stock		
Development land for market sales		
Other (please specify below):		

Other: by type(s) and approximate amounts if more than one

3. QUESTIONS RELATING TO THE CONSULTATION

14. HM Treasury is yet to confirm the rate of the proposed Residential Property Developer Tax but, at this stage, would you adjust your development plans, build-out strategy, or land acquisition strategy in response to the tax being introduced? *

- ☐ Yes, as I expect the tax implications to be significant
- ☐ Yes, although I expect the tax implications to be negligible
- ☐ No, I expect the tax implications to be negligible
- ☐ No, even though I expect the tax implications to be significant

15. How would you adjust your plans in response?

- [ ] Stop involvement in residential development projects altogether
- [ ] Reduce involvement in residential development projects (please quantify reduction in the comments box below)
- [ ] Other response (please provide information in the Comments box below)

Comments:

16. Please outline briefly why there would be no change in your plans (e.g. you are not developing residential accommodation, you are only buying standing investments, you do not think the rate of Residential property developer tax is likely to be high enough to impact the attractiveness of the section for investments etc.).

17. Do (or did) you own and/or developed any residential accommodation with ACM/other cladding since deemed to be unsafe? *

- [ ] Yes
- [ ] No

18. What is the current position regarding this cladding?

- [ ] In the process of removing it at my organisation's expense
- [ ] In the process of removing it at another organisation's expense
- [ ] It has been removed at my organisation's expense
- [ ] It has been removed at another organisation's expense

19. Did/would you qualify for any government remediation funding to support the removal of this cladding? If relevant, please provide details in the box below.

- [ ] Yes
- [ ] No

Details of government remediation cost recovery

20. Would your response to the proposed tax change be different if it was introduced at a later date (rather than April 2022)? (For example, the impact of any tax changes brought in, at the earlier date, may not be reflected in current feasibility studies.) If Yes, please give details in the Comments box below. *

- [ ] Yes

No

Comments:

21. Is there any additional information (or timings) required, from HM Treasury, to help inform your view on the proposed tax?

22. Please add any further comments that you may have relating to the proposed Residential property developer tax.