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Pooled Property Funds for Investment in UK Property

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Identifying your objectives

The search for efficient ways of setting up pooled property funds has resulted in a number of structures being devised for open ended and closed ended property funds, both onshore and offshore, and for retail and institutional investors.

The most appropriate vehicle depends on your particular circumstances:

- **the target market**

  Will there be retail and/or institutional investors? Will there be tax exempt investors – and, if so, what kinds of tax exempt investors? Will there be non UK investors – and, if so, where and of what kind?

- **the investments**

  What type (e.g. commercial and/or residential) and where are the proposed investments and what flexibility is required relating to the management of those investments?

- **tax efficiency**

  What (if any) tax incentives are available and how efficient is the flow through of income and capital gains with minimum tax leakage? This needs to be considered having regard to the target market and the proposed investments.

Fund structure options

A table comparing the main structures which might be relevant to a pooled fund investing in a UK property is attached to this Memorandum. It covers the following options:

- **Syndicated direct purchase arrangements**

  The simplest route for a property investment is of course a direct purchase of property by a single retail institutional investor. For larger commercial developments in particular, it may be more practical to look for a syndicate of a number of potential investors to acquire a particular property.

  Up to four investors may jointly purchase the property and be on the legal title – they will hold the property on trust for the benefit of persons identified in a trust deed. The beneficiaries will often be the same as the owners of the legal interest but may include additional beneficiaries. The relationship of the investors needs to be documented in a separate declaration of trust.

  The two principal attractions of this method are that it is tax transparent and the trust deed can be an extremely flexible and comprehensive way of regulating the legal relationship between a relatively small number of investors.

  It may however have its problems deriving from regulatory issues if it might constitute a collective investment scheme or alternative investment fund. It may have practical problems too because an individual investor may have great difficulty in using its share as security for funding; marketing and disposal of a share in an illiquid market may give rise to problems which are only partially resolved by initial granting of pre-emption rights and beneficiaries are unlikely to escape joint and several liability in respect of the entire investment.

  Consequently syndicated purchase arrangements can be attractive for a small number of particularly institutional investors who will be involved with managing the property. For a larger group of investors or for funds which are to be promoted on a wide basis they usually become impractical or there is a preferable alternative structure.

- **Limited partnerships**

  Limited partnerships established under the Limited Partnerships Act 1907 have become a well developed investment fund structure, particularly for closed ended funds with exposure to property and private equity.

It involves setting up a limited partnership, with all the constitutive arrangements being set out as agreed in a limited partnership agreement:

- one or more general partners who are liable for all the debts and obligations of the partnership – only the general partner is entitled to take part in the management of the partnership's business; and

- one or more limited partners, who are the investors, who contribute capital which cannot be withdrawn until the partnership is terminated. The liability of limited partners for the debts and obligations of the partnership is limited to the capital contributed. Limited Partners may not take part in the management of and have no powers to bind the partnership.

It was originally relatively simple on the regulatory front – with the operator of the fund being required to be an authorised person and either being the GP itself or an operator appointed by the GP, but regulation has become complicated now that limited partnerships are alternative investment funds and subject to AIFMD requirements.

The tax transparency for a limited partnership and the limited liability of the limited partners are obviously attractive features (although it is worth noting that the SDLT treatment of limited partnership transactions can be complex). The question to consider in any particular set of circumstances is whether the various restrictions on the specification of the limited partnership still allow sufficient flexibility and whether it can be promoted to, and be tax efficient for, all intended prospective investors. Also the need to deal with appointment of an alternative investment fund manager or AIFM for a limited partner structure means that it is also subject in effect to more extensive regulation than in the past.

- **UK unauthorised unit trusts**

This term covers a number of types of structure but the typical features of a UK unauthorised unit trust involve:

- a lengthy trust deed which constitutes the fund setting out the full terms of the vehicle including all investment restrictions

- entered into by a Manager with responsibility for managing the scheme and a Trustee which holds the assets and has a duty of oversight. These parties now act as the AIFM and depositary for AIFMD purposes respectively.

Unauthorised unit trusts can be made available to the limited categories of investors to whom unregulated collective investment scheme (UCIS) and AIFs may be promoted by authorised persons. These categories are not so wide as the general public but it does allow access by a relatively wide range of those other than basic retail investors. Please see our separate briefing paper on how these UCIS provisions have recently changed.

From the tax perspective, they have tended to be tax efficient where made available only to exempt holders i.e. registered pension schemes and other entities which are wholly exempt from tax on capital gains otherwise than by reason of residence – and these are referred to as exempt unauthorised unit trusts. Such schemes are limited by their constitutive document to issuing units only to such exempt investors who will in practice likely be pension schemes or charities.

An unauthorised unit trust is therefore a very flexible vehicle in that the terms of its trust deed can be written to the desired specification but there may be a taxation drawback other than for exempt unauthorised unit trusts and there can be marketing difficulties. Unauthorised unit trusts tend to be suitable for, and are usually made available to, UK exempt institutional investors.

- **JPUT or corporate feeder into underlying limited partnership**

This option has developed out of the issues which arose for use of limited partnerships. For various tax reasons (principally in relation to stamp taxes), many limited partnership property funds were moved into Jersey property unit trust (or JPUT) structures and most had a JPUT imposed on top of the original English limited partnership. The original stamp taxes issue which encouraged many JPUTs to be established has now been removed for the transfer in of the property to such a JPUT but many now exist as JPUTs on an ongoing basis.

For new propositions and in order to keep the management of the UK property onshore it is often efficient to have an English limited partnership which still manages the property but for investors to come in through a JPUT or corporate feeder established in Jersey, as appropriate.

This option does multiply the number of funds to be established and introduces the question as to how one best manages the Jersey feeder structure. One needs appropriate procedures of management and control of that feeder fund in Jersey. Nonetheless it has proved a popular option, and administrative support services are available.

- **Authorised property unit trusts, and PAIFs**

  Since 1991 it has been possible to set up UK authorised property unit trusts. Since 2001 UK authorised open ended investment companies investing in real property have been available. Property funds can now be established as either unit trusts or ICVCs (or authorised contractual schemes (ACS), although they are beyond the scope of this memorandum).

  An advantage of an authorised fund is that, if established as a non-UCITS retail scheme (or NURS) it can be made available to the general public, whereas most of the property fund structures are limited in their marketability. Their main advantage is that as a UK authorised fund they are exempt from tax on capital gains.

  There are however drawbacks:

  - Managing a UK authorised investment fund requires appropriate parties who can provide services for such vehicles (manager and depositary), and for the vehicle itself to be subject to detailed regulation set out in the FCA's COLL and FUND Sourcebooks.

  - A principal concern is that a UK authorised fund is by definition essentially open ended and this may not suit funds investing in property, which is an illiquid asset class. Certainly overall tax inefficiencies of UK Authorised Property Funds (e.g. the liability to taxation on income) have been a longstanding issue but it has largely been resolved by the introduction of the PAIF regime. This is an elective tax regime to which most authorised property funds are now gradually converting. The rules for PAIFs require the streaming of income received by the fund. The new tax regime for PAIFs moves the point of taxation from the fund to the investor so the fund itself will be exempt from tax on income it derives from property holdings (as well as on capital gains) and an investor will be taxable on the income as property income. This PAIF regime only applies to ICVCs and so some established authorised property unit trusts have converted to an ICVC structure in order to take advantage of the PAIF tax regime.

  - Authorised property funds which are PAIFs therefore have advantages in that they can be made generally available but they are heavily regulated products. This means that they may well be suitable for retail investors but only if there is scale and suitable infrastructure available, and the property management issues and relevant liquidity issues can be managed.

- **UK REITs**

  The UK introduced its REITs regime in January 2007 with the aim of facilitating improvements in the property investment market in the UK. The UK REIT regime is an elective tax regime which is available to closed ended listed companies conducting property rental business meeting certain criteria.

  From a tax perspective the main aim is to ensure that returns from different forms of indirect and direct UK property investment are taxed in broadly the same way – certainly so that previous tax inefficiencies of investing indirectly in property are removed. Like REITs which are available in other countries they enable a wide range of shareholders to benefit from participation indirectly in property investment, the intermediate REIT company owning and managing rental property with a view to generating income in the form of dividends for shareholders.

  The UK tax effects for a REIT are the same as for a PAIF.

  If you are interested in further details please see our separate briefing paper on the UK REITs regime.

  Whilst in theory an attractive option, note that REITs are now subject to the AIFMD regime and so will be subject to the need to appoint an alternative investment fund manager or AIFM and so the AIFMD provisions; and of course are subject to the regime which applies under the relevant listing rules for the closed ended corporate structure selected.

Which option to choose?

Deciding on the appropriate fund structure for your particular commercial proposition requires detailed analysis beyond the scope of this briefing paper. This document is intended only as a brief overview of the likely key fund structures which might be of relevance. It does not seek to be comprehensive as to the structures available, nor to be comprehensive in describing the features of any particular structure.

We would be pleased to discuss particular issues arising for your specific pooled investment fund propositions which you may be considering.

For advice please contact Kirstene Baillie or Nicholas Noble or your usual contact at Fieldfisher.

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Fund structures for pooled investment in UK property[1] – current options:

	Syndicated Direct Purchase Arrangements	Limited Partnerships	UK Exempt Unauthorised Unit Trusts	JPUT or Corporate Feeder into Underlying Limited Partnership	Authorised Property ICVCs which are PAIFs	UK REITs
Structure	No intermediate vehicle – direct investment.	Fund vehicle interposed.	Fund vehicle interposed.	Two levels of fund vehicle interposed.	Fund vehicle interposed.	Fund vehicle interposed.
Nature of scheme	Trust for sale.	Limited partnership.	Unit trust scheme.	Top layer unit trust scheme or corporate. Underlying LP.	Unit trust scheme or ICVC (a UK authorised OEIC).	Company.
CIS and /or AIF?[2]	May be a collective investment scheme and an AIF.	Unregulated collective investment scheme and an AIF.	Unregulated collective investment scheme and an AIF.	JPUT and LP are, and corporate feeder may be, an unregulated collective investment scheme. Each fund is an AIF.	Collective investment scheme and an AIF.	AIF.
Parties	Syndicate members and possibly a trust corporation or other nominee.	Limited partners, the investors (with limited liability). General Partner (unlimited liability). AIFM is General Partner or the appointed Manager. Appointed Depositary.	Manager. Trustee.	JPUT: a managing trustee or manager plus trustee. LP: as for limited partnerships. Corporate feeder: board of directors or may be an appointed AIFM.	Authorised fund manager (ACD of ICVC or manager of a unit trust). Depositary appointed.	Board of directors –self managed? Or appointed AIFM?
Relevant Regulators/ Regulation	None (provided not an AIF).	Appointed AIFM of the limited partnership regulated by the FCA. Need to comply with AIFMD obligations to appoint a Depositary which will also be regulated by the FCA.	Manager and Trustee both regulated by FCA.	Local Jersey licencing depending on nature of JPUT (perhaps administrator). May be regulation of appointed AIFM of LP. May be regulation of depositary (and watch depo light possibilities).	AFM and Depositary both authorised (by FCA). Fund authorised by FCA. See FCA's COLL Rules and also FUND Sourcebook.	Listed on recognised Stock Exchange so relevant Listing Rules apply. Need to comply with AIFMD obligations to appoint an AIFM (or self managed so board is AIFM) and appoint a Depositary. AIFM and Depositary will be regulated by the FCA.
Investments	As agreed by syndicate members.	Set out initially in the objective in the Partnership Deed. Thereafter determined by GP/manager, possibly with input from limited partners re strategic but not day-to-day management matters.	As set by the Manager pursuant to any investment objective in Trust Deed.	As set out in the investment objective of the LP and as influenced by feeder funds, depending on terms of their Constitutive Documents.	As set out in the prospectus of the Fund (unitholder resolution is required to change investment objectives).	Published investment policy required (and changes require the prior approval of shareholders to any material change).
Investment restrictions	As agreed.	As set out in the Limited Partnership Agreement.	As set out in the Trust Deed.	As set out in the Limited Partnership Agreement.	As set out in FCA's COLL Rules for applicable vehicle (NURS or QIS), subject to overlay of FCA's FUND Rules as vehicles are now AIFs. If a non UCITS retail scheme ("NURS"), must ensure there is a prudent spread of risk and meet the specific property investment conditions in COLL 5.6.[3] If a Qualified Investor Scheme, must take reasonable steps to ensure a spread of risk taking into account the investment objectives and policies of the scheme as stated in its prospectus and in particular any investment objectives with regards to the unitholders. Fewer constraints on investment powers generally but see COLL 8.4.[4]	As set out in published investment policy which must contain information regarding asset allocation, risk diversification and gearing and include maximum exposures. Must also meet REIT HMRC legislation tests which include specific investment related issues.[5]

[1] Assumes no residential property.

[2] CIS means a collective investment scheme as defined for UK Financial Services and Markets Act 2000 purposes. AIF means an alternative investment fund as defined for the purposes of the EU Alternative Investment Fund Managers Directive.

[3] Note investment limits in COLL 5.6.19 so no more than 15% in any one immovable increasing to 25% in certain circumstances); income receivable from any one group in any accounting period attributable to immovable must not comprise more than 25% (or in the case of a government or public body, more than 35%); no more than 20% to consist of immovables that are subject to a mortgage and any mortgage must not secure more than 100% in value; and some aggregated values superimposed further constraining use of mortgage property borrowing, for the scheme and unapproved securities; no more than 50% in value to consist of immovable that are unoccupied and non income producing or in the course of substantial development re development or refurbishment; no option may be granted to a third party to buy any immovable comprised in the property unless the value does not exceed 20% of the value of the overall fund property (with any unregulated collective investment scheme and unapproved securities) standing independent valuer and valuation provisions apply.

[4] Investment limits for immovables are in COLL 8.4.12 and include that the amount secured by mortgages over any immovable must not exceed 100% of the latest valuation by an appropriate valuer; no option may be granted to buy an interest in any immovable if this might unduly prejudice the ability to provide redemption of units and total all premiums paid for options to purchase immovable must not exceed 10% of the scheme value in any 12 month period.

[5] Must meet balance of business test which is intended to ensure that most of the REITs activities are concerned with tax exempt property rental business. At least 90% of the net income profits of its tax exempt property rental business arising in the accounting period must be distributed by way of dividend. The company must carry on the property rental business in respect of which two conditions must be satisfied – it involves at least three properties and no one property represents more than 40% in total value of the properties involved in the property rental business (these conditions being designed to ensure there is a reasonable spread of risk in the property portfolio).

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Fund structures for pooled investment in UK property – current options (continued):

	Syndicated Direct Purchase Arrangements	Limited Partnerships	UK Exempt Unauthorised Unit Trusts	JPUT or Corporate Feeder into Underlying Limited Partnership	Authorised Property ICVCs which are PAIFs	UK REITs
Valuation	As agreed.	As set out in the Partnership Deed and subject to AIFMD issues.	As set out in the Trust Deed and subject to AIFMD issues.	As set out in the relevant constitutive document and subject to AIFMD.	As set out in the constitutive document, required by the COLL and FUND Rules for the relevant type of fund and subject to AIFMD requirements. Standing independent valuer required.	As set out in the Constitutive Document and Prospectus – and subject to AIFMD issues.
Possibility to realise investment	Trust for sale with power to postpone sale as provided in trust deed.	Usually locked in for a certain period although limited transfer possibilities usually included.	Can be open ended, closed ended, or somewhere in between - as provided for	Typically closed ended although, with double layer structure, it is possible to provide for some	Basically open ended fund but this is subject to some limited powers set out in the COLL Rules qualifying this.[6] Power to suspend dealings in units only in exceptional circumstances.	
Administration and operational issues	Direct purchase. No requirements except as agreed.	As in Limited Partnership Agreement.	As in Trust Deed.	As in constitutive documents as appropriate.	As in constitutive documents plus as required by COLL and FUND Rules.	Subject to constitutive documents and Listing Rules requirements.
Tax	Syndicate members taxed as if making direct investment.	Tax transparent. Limited Partners taxed as if making direct investments.	Unit trust scheme taxed as a company for capital gains purposes. If only exempt investors, trust exempt from tax on capital gains. Income flow through efficient where there are only tax exempt investors.	Tax efficient if relevant feeder offered (non-UK corporate feeder for non UK investors and non domiciled UK investors). LP and JPUT are tax transparent for income. JPUT and Corporate are not liable to tax on capital gains as non residents but necessary to consider section 13 TCGA 1992 if will be any 25% plus	PAIF is exempt from tax on capital gains and rental income. However it follows full distribution policy and distributions are taxed as UK property income.	Elective regime. Tax exempt property rental business is ring fenced for tax purposes so that profits, losses and gains of that tax exempt business can be isolated from other activities and profits arising from the tax exempt business are not charged to corporation tax. Whilst relevant profits are not taxable within the company, distributions from tax exempt profits fall to be taxed as property income in the hands of the investor rather than company level and, if there are other profits, these will be taxed in the REIT and the distributions of such profits will have the same tax treatment as a normal dividend.
Promotion possible to	Not applicable.	Limited categories of investors only – as possible for a UCIS and AIF.	Limited categories of investors - as possible for a UCIS and an AIF and also may be restricted if limited to exempt investors for tax reasons.	Limited as applicable for promotion of a UCIS and AIF as appropriate.	If NURS scheme, available to the general public . If a QIS scheme restricted categories of potential investor set out in COBS 4.12 of the FCA Rules for non mainstream pooled investments.	General public, as offering of shares in a listed company.

[6] For a NURS scheme, no fewer than two regular valuation points in any month although, if limited redemption arrangements, valuation points must be as in the Prospectus and must not be set more than six months apart and it must be valued on prices published at least once in every month. Limited redemption, deferred redemption and limited issue provisions available.

For a QIS, valuation terms in accordance with provisions of the Instrument and Prospectus as appropriate any limitation on issue and redemption of units to be stated in Instrument.

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