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19th June 2014

Dear Sir / Madam

**Treasury Consultation: Implementing a capital gains tax on non-residents**

**Introduction**

Avenue Capital Student Real Estate (ACSRE) i

concerns and suggested amendments to the proposed changes.

This letter outlines our primary

**Background on ACSRE**

**Purpose-Built Student Accommodation (PBSA)**

**General**

In general terms the introduction of the new CGT regime will operate as a significant disincentive to much needed institutional investment in UK residential property and in particular in the student accommodation sector unless appropriate exemptions are made available. We do not understand the policy rationale for including student accommodation of any kind within the scope of residential property subject to charge under the new CGT regime. However, we would in any event expect the new CGT regime to provide for some form of "institutional investor" exemption, potentially

incorporating a “close company” type test including the new REIT regime concept of “institutional investor” to exempt entities owned by such investors. We would also expect fund vehicles which satisfy a genuine diversity of ownership test to be exempt from any charge under the new CGT regime. In addition, where in a property holding structure, the top holding company meets any such test it will be important that any underlying asset owning SPVs also take the benefit of the exemption from the charge. These measures will, in our view, be critical to trying to mitigate the harmful effect the introduction of the new CGT regime will have on the UK residential property market and in particular overseas investment therein.

## Overview

We note the government’s proposal that residential accommodation for students should only be excluded from the scope of the new CGT regime if it is a “hall of residence attached to an institution”. It is our view that all PBSA for higher education institution (HEI) students should be excluded from the scope of this regime, even where owned and operated entirely independently of any particular institution of higher education.

It is essential for the government to have regard to the shortage of quality residential accommodation for students in the HEI sector and its impact on the wider UK population. The growth in the number of students attending HEIs has put considerable pressure on residential accommodation, yet funding constraints on universities have made it difficult for universities to finance the construction and/or operation of student accommodation themselves. Crucially, accommodating students within the private residential housing market reduces capacity for homes for the wider population and exacerbates the UK’s current housing crisis, for which there is no solution other than to increase supply.

In university cities around the UK, the under-supply of quality student accommodation is increasingly being met by PBSA developed, owned and/or operated by independent providers. There is a huge diversity of arrangements under which PBSA may be owned and operated, but fundamentally, all of these arrangements achieve the same objective – the provision of PBSA for students in HEIs. Private investment in PBSA is addressing a need which the HEIs sectors are themselves poorly equipped to meet, and transferring the costs and risks of providing quality large-scale student accommodation. It also increases capacity in the wider residential property market by relieving pressures on private accommodation occupied by students – more of which later. In addition, the availability of quality student accommodation is a factor in attracting overseas students to UK universities, which has become an increasingly important source of additional funding for UK universities.

In essence, imposing CGT would reduce investment returns and thus investment in the sector - at a time when it is already undersupplied. The undersupply argument is supported by a recent Savills research report “UK Student Housing” referring to up to 50% of beds in their survey cities comprising lower quality halls of residence – two-thirds managed by universities – of which 16% are lower quality blocks in poor locations. The Savills report also identified a number of locations in England, Wales and Scotland where the provision of new PBSA could release 77,000 homes back onto the market by increasing the market share of PBSA at the expense of houses in multiple occupation (HMOs)

Furthermore, excluding new build from CGT would not fix the problem to the extent that CGT would apply to existing and prospective owners of standing stock it would reduce returns meaning necessary upgrade and improvement works would not be viable, so risk capital like ourselves that is prepared to enter the UK student housing market and upgrade (prime) located stock will be disincentivised, and this would further exacerbate the undersupply of quality PBSA.

We cannot support an exemption which discriminates against independently owned and operated PBSA. If a PBSA accommodates students of HEIs, then it should be irrelevant to what extent a particular institution has an interest in the property or is formally or informally engaged in operating the property. We do not see what underlying policy could justify levying tax based on lack of attachment to a particular institution.

A considerable amount of the capital invested in PBSA today comes from outside the UK. Should PBSA be brought within the charge to CGT in the manner proposed, this would represent a fundamental change to the conditions for business in the UK for investors in this sector, will have a direct and negative impact on investment returns and, in all likelihood, discourage the much-needed continued investment in this sector

#### **Further detail on considerations relevant to the scope of an exemption for residential accommodation for students**

The reference to "hall of residence attached to an institution" in the consultation document is unclear for a number of reasons.

First, in its reference to "hall of residence for students in further or higher education", is the government intending to limit the proposed exemption only to traditional-style PBSA, even if it satisfies the further requirement of being "attached to an institution"? In this regard, we note that "the government does not believe that disposals of multiple dwellings in a single transaction should be excluded from the CGT charge".

We do not see that such a distinction is justified in the context of the proposed new CGT charge, as it would be entirely arbitrary to levy CGT depending upon the particular configuration of the accommodation. However, this should be clarified since in other areas of tax law there is a distinction drawn in the legislation and/or in published HMRC guidance between the tax treatment of residential accommodation depending on whether or not it constitutes "dwellings". For stamp duty land tax (SDLT) purposes, residential accommodation for students is treated as one or more "dwellings", unless it is a "hall of residence for students in further or higher education". Based on HMRC's published guidance, much of the modern PBSA existing today, which comprises self-contained studio flats or "cluster flats" for multiple occupants, would qualify as dwellings for these purposes and so, not a "hall of residence".

Second, the meaning of "attached to an institution" is unclear. Other areas of tax law provide special tax treatment to student accommodation without any such requirement. In particular, property used for the residential accommodation of students attracts exemption/zero rating under the VAT legislation. Before imposing any qualification that the accommodation should be "attached to an institution", the government should be aware of the spectrum of arrangements under which a particular institution may be involved in the accommodation of students and hence the complexity of seeking to create such a qualification (which, fundamentally, we cannot support).

For example:

- a university may own the freehold of the property, having acquired the accommodation from a third party or built the accommodation itself;
- it may grant a long leasehold interest of the property to a third party and immediately take a lease back over the whole of the property. The lease back could be for an extended period, e.g. more than 21 years, or a much shorter period;
- it may sell the freehold of the property to a third party and immediately take a lease back of the whole of the property. Again, the lease back could be for an extended period, e.g. more than 21 years, or a much shorter period. The university may have an option to buy back the freehold at some point in the future;
- it may sell the freehold of the property to a third party and enter into a nominations agreements under which it is entitled to nominate its students to occupy the accommodation. This may be a "hard" nominations agreement, under which the university is contractually obliged to nominate students and must pay the costs of any rooms not taken up, or merely a "soft" nominations agreement, under which risk of "voids" is not borne by the university;
- it may sell the freehold of the property to a third party and enter into a reservation agreement under which it is entitled to reserve rooms in the accommodation for occupation by its students;
- the leases, nomination agreements and reservation agreements referred to above could be entered into by the university only in respect of part of the accommodation, with the third party freeholder or long leaseholder either directly letting the accommodation to students and/or entering into corresponding leases, nomination or reservation agreements with other institutions in respect of remainder of the property;
- PBSA built and owned independently of any university may accommodate students of one or more universities pursuant to leases, hard or soft nomination agreements or reservation agreements entered into with one or more universities over part or all of the property; and
- finally, PBSA built and owned independently of any university could be entirely direct let to university students, without any involvement on the part of any university. Depending on the number of HEIs in the city concerned, these could be students of one or several institutions.

It is not clear which of these arrangements the government intends to fall within the scope of "attached to an institution" and to whose interest the government intends the exemption to apply – to the university's, the third party's or both. What is clear, however, is that it is the last two scenarios which have becoming an increasingly important source of supply of PBSA. Our view is that all PBSA should be exempted from the new CGT charge, without needing to be "attached to an institution". If the government is keen to distinguish genuine student accommodation from non-student residential dwellings it would surely be simpler to look to the nature of the occupiers rather than some form of "attachment" to an educational institution. This would also avoid any unintended distortions in the impact of such legislation on deal structures used by the institutions in their relationships with the private sector.

The government should note that any exemption for PBSA should be sufficiently flexible to ensure that incidental non-student use (for example, occupation by those which manage the property or wardens) does not prevent the exemption from applying. In addition, the exemption must be sufficiently flexible to ensure that use of the accommodation outside of term time does not prevent

the exemption from applying; both universities and private operators of student accommodation may derive income from letting rooms during the summer vacation, to attendees at conferences or summer courses, or otherwise. It should also be ensured that any exemption applies to residential accommodation for students which has been converted from other use, whether general residential or commercial.

### **Distinguishing student accommodation from other residential accommodation**

The consultation document refers to a potential exception for student accommodation that is "attached" to educational establishments. We suggest that HMRC should entertain an exclusion of larger scale student accommodation in order to achieve the benefits outlined above – i.e. greater supply releasing housing stock for families - of the type that attracts significant institutional inward investment. The challenge is to establish a methodology for defining larger scale PBSA accommodation (as distinct from conventional residential homes that happens to be occupied by students). It seems to us there are two possibilities, as follows:-

#### **a. Planning Use Classes**

The Town & Country planning regime, specifically the Use Classes Order, does not explicitly distinguish between large-scale PBSA from other residential dwelling uses. Generally a typical modern PBSA block would comprise a mix of studio flats which would be a C3 use and cluster flats which would be C4 (for 3-6 occupants) and any unit with more than 6 would not be classified (generally known as "sui generis"). These use classes do not, in their current form, distinguish between the different types of occupants and, therefore, do not identify that a PBSA might be designed for use by students even if plainly non-students would be unlikely to wish to occupy such accommodation (and the investor would not be willing to let to anyone other than students). We recognise, therefore, that in its current state the Town & Country planning regime does not assist in categorising different types and quality of PBSA. However, this may change and could be considered if that regime developed further.

#### **b. Houses in Multiple Occupation (HMOs) and the Code of Practice regime**

Although the Use Classes Order does not make a useful distinction, UK Government has implemented a Statutory regime which we believe could adequately make the type of distinction referred to above, namely through the Housing Act 2004. The relevant part of the Housing Act 2004 imposes a regulatory regime for HMOs. Since that Act came into force there have been further developments to ease the regulatory burden the latest one, relevant to this context, being The Housing (Codes of Management Practice) (Student Accommodation) (England) Order 2010. In short, this Statutory Instrument relates to the approval by the Secretary of State for Communities and Local Government of two Codes of Practice both in respect of "larger developments" of student accommodation (one for those managed by educational establishments and ones that are not). Copies of both these codes of practice may be obtained from the National Administrator for the ANUK/Unipol National Code of Standards based at Unipol Student Homes 155-157 Woodhouse Lane, Leeds, LS2 3ED: see [www.unipol.leeds.ac.uk](http://www.unipol.leeds.ac.uk) or [www.anuk.org.uk](http://www.anuk.org.uk). In our experience the majority of institutional investment grade PBSA sites are managed by parties that have signed up to one of those Codes of Practice. Larger developments are those which comprise buildings occupied by more than 15 students.

We would be concerned that if any exemption or exception were introduced for PBSAs that are "attached" to educational establishments that it would distort the investment market in favour of those properties with a qualifying "attachment" to an educational establishment. The market has a broad spectrum of relationships between the private sector investors and educational establishments. This can range from sale and leasebacks or lease and leaseback arrangements where the educational

establishment has a freehold and/or leasehold proprietary interest through to a reservation agreement which is little more than an intention to do business. If a distinction was made from a tax perspective to a contractual relationship with an educational establishment one could easily envisage the distortion in the market.

Accordingly we would recommend HMRC considers applying an exemption to those investors who sign up to the relevant Code of Practice (whether that is directly or indirectly through a service provider).

We remain at your disposal should you have any questions or require further details.

Yours faithfully