



Investing in UK Real Estate?

Investment vehicles

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Investment vehicles

In this note, we consider some of the factors which may influence the type of vehicle or structure to be used when an investor decides to invest in the UK. We have also summarised a few of the more popular vehicles and listed their primary advantages and disadvantages, the majority of which are tax related. However, this is not an exhaustive list and, clearly, does not address the requirements of all potential investors, which would need to be considered on the facts.

Issues affecting the type of vehicle/structure when making an indirect investment

- **Control and decision making** - certain vehicles, in order to protect the efficacy of their structure, prohibit investors controlling the assets held by the vehicle. This is true of English Limited Partnerships. If you as investor are looking to make day to day decisions in relation to your assets then these vehicles may not be suitable for you.
 - **Cost** - investing indirectly is generally more expensive at the point of set up than acquiring an asset directly. There are the on going running costs of the vehicle and additional potential regulatory costs.
 - **Size and number of assets** - where an investor is only proposing to hold one or two assets it may be more efficient to hold them directly. Where there are multiple assets there is merit in establishing an umbrella vehicle which can allow central management and increase the options on the future sale of the assets.
 - **Location of the management team** - if the management team is not based in the UK you will need to consider how the asset will be managed on a day to day basis within the vehicle. Typically an asset manager is appointed to undertake this task to ensure efficiency and in some cases to ensure that the investors may retain their offshore tax status.
 - **Long term objectives** - do you intend the assets to be held for investment purposes or for trading? The answer to this question will affect the type of vehicle you choose. English Limited Partnerships for example are most commonly used for investment type assets whilst Limited Liability Partnership or Companies are often used for trading assets.
- **Other investor requirements** - certain vehicles are more or less attractive to different types of investors. Some investors have restrictions within their own constitutions which prohibit their investment into certain vehicles. Equally certain jurisdictions do not recognise all the alternative vehicles available in the UK.
 - **Regulatory compliance** - certain vehicles have additional regulatory compliance requirements. For example, the English Limited Partnership is governed by the Financial Services Authority ("FSA") and requires an "authorised person" to operate and manage it. If you do not have an authorised vehicle within your group you will need to contract with a third party to provide this service to the vehicle. Some structures are more heavily regulated than others. The degree of regulation may impact on the type of investors that can invest and the activities of the vehicle.
 - **Multiple vehicles** - often investors hold their assets through a series of vehicles in order to maximise both the tax efficiency of the structure and also the exit options for the investors. This may involve a combination of vehicles. Equally certain investors may require a feeder vehicle through which to invest into the main holding vehicle.
 - **Investment strategy** - if the investor is to retain the investment for any length of time, it will wish to ensure that the tax, control and regulatory aspects of the investment vehicle conform to its requirements. Equally, if it is intended to hold the investment for a short time only, it will be necessary to ensure that these characteristics do not prejudice liquidity.
 - **Taxation of the vehicle** - the summary below looks at some of the tax issues affecting different structures. In particular, the stamp duty land tax ("SDLT") position will need to be considered, as this could be the main set-up or transactional cost. On-going tax will also be relevant and may depend on the likely level of the investor's involvement.

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- **Term, exit and liquidity** - some types of vehicles have established markets for the trading of interests, others may be more limited.

In some cases a combination of the structures described below may be needed to achieve the requirements of all anticipated investors.

English Limited Partnership (“ELP”)

ELPs have traditionally been popular vehicles for indirect real estate investment, because they are tax transparent for direct tax purposes, enabling different types of investor to invest together, but to be taxed according to their individual status.

ELPs offer limited liability to investors provided that they are not involved directly in management. Investors in an ELP are known as limited partners. All ELPs have at least one limited partner and must have one general partner. The general partner has control over the management of the partnership and unlimited liability for the debts and obligations of the partnership.

SDLT has, however, recently been imposed on transactions involving partnerships. Contribution of property to a partnership and a transfer of a partnership interest would trigger a 4% charge on the gross underlying asset value of the interest acquired or transferred. If liquidity is sought, an ELP would not be an ideal option for this reason, but it may still be an appropriate investment vehicle where a long term investment is anticipated, there is limited debt or where the property is in a disadvantaged area.

ELPs are sometimes used in conjunction with offshore vehicles to enable day to day management of the property assets to take place onshore, without prejudicing the general tax status.

Interests in an ELP would be classified as units in an unregulated Collective Investment Scheme, and could not generally be marketed to private individuals.

Generally, an ELP requires an FSA authorised operator. This can add to the cost of using this vehicle. However, the ELP remains one of the most popular vehicles for indirect investment in the UK.

English limited liability partnership (“LLP”)

An LLP is popular where all partners wish to be involved in management of the vehicle and in such a

case can avoid the need for an FSA authorised operator.

A limited liability partnership is a body corporate with, generally speaking, limited liability and which is treated as transparent for UK income and capital gains tax purposes.

Investors in an LLP are known as members. Each member has an undivided share in the assets of the LLP and is involved in the day to day management of the vehicle.

However, where an LLP is a property investment partnership, tax exemption on income and gains is denied to exempt funds, life funds and certain other bodies (but not charities). Accordingly, this is not likely to be a suitable investment vehicle where entities of this type may become investors or otherwise acquire an interest.

Contribution of the property to and transfer of an interest in an LLP would carry the same SDLT liabilities as outlined above for an ELP.

Depending on the length of the commitment period and the redemption method, an LLP could be structured so that it is not a collective investment scheme.

UK general partnership

A general partnership is generally tax transparent, but this status may be lost if the structure amounts to a collective investment scheme.

Again, the SDLT charges outlined above for ELPs would apply, and may render this vehicle unsuitable if a liquid investment is sought.

Partners in a general partnership are jointly and severally liable, and each investor can bind the partnership.

UK corporate vehicle

A UK resident company is commonly used by investors as the asset they are acquiring is often already held by a company. However, generally, companies are unattractive as indirect vehicles as they are not tax transparent and do not provide exempt investment returns for charities, exempt funds, UK individuals and offshore investors. The company is potentially liable to tax at 30% on its income and chargeable gains, while the transfer of

the contribution of the properties to the company would trigger a 4% SDLT charge.

While transfers of the shares in the company would attract only 0.5% stamp duty as opposed to 4% on a land transfer, a share purchase may not be attractive to corporate investors either if there are historic capital gains in the company, which would be subject to charge on realisation. Acquisition of companies is however more palatable where the asset is held in a single purpose vehicle which has been established solely to hold the relevant asset. If this is not the case then extensive due diligence should be undertaken before acquiring the company.

Companies are often used below ELPs to hold individual assets to assist with alternative exit strategies.

A UK listed company has clear advantages in terms of its wide potential investor base, but trading history requirements often make listing impractical.

Listed companies are suitable for investors who are ISAs, Self Invested Personal Pensions ("SIPPs") and Small Self-Administered Schemes ("SSAS") which may make them more attractive to retail investors.

Use of partnerships

Partnerships are frequently used as key components in the structuring of indirect investments. The benefits of partnerships include the following:

- flow-through tax treatment
- flexible remuneration arrangements for general partners
- flexible internal governance and control.

As partnerships are generally treated by fiscal authorities in the UK and the US as tax transparent for purposes of direct taxes, partners are treated as having invested directly in the underlying assets held by the partnership. Direct tax at the partnership level is generally either minimal or non-existent.

Types of partner

A limited partnership has two categories of partner:

- general partners, who have control over the management of the partnership and unlimited liability for the debts and obligations of the partnership

- limited partners, who are passive investors in the activities of the partnership and whose liability to the partnership is limited to their contributed capital.

The partnership agreement will allocate costs between the limited partners and the general partner. Those expenses related to the initial structuring, the on-going operation and the investment activities of the partnership will be the responsibility of the limited partnership. The general partner will traditionally cover its own internal costs of operation. However, where fund expenses may have placed an unnecessary drag on fund performance, especially in the early years, a fund manager may cap the amount payable by the fund and cover the remaining amount itself.

A partner's interest in a partnership will be based on its capital account, which rises and falls in two ways:

- due to contributions and withdrawals of capital by a partner
- due to profits or losses of the partnership allocated to the partner.

The manner in which allocations of realised and unrealised gains and losses, together with income and expenses, are made will be governed by the partnership agreement.

Every limited partnership must have a general partner. In some respects the need to nominate or establish an entity to serve in this role has been a drawback to using partnerships. The rise of limited liability companies in the United States and limited liability partnerships in the United Kingdom reflects an attempt by legislatures to provide a vehicle with the flexibility of a traditional limited partnership, but without the formal requirement for a general partner.

A general partner may be either an individual or, more commonly in funds, a legal entity, which may be specifically organised for this purpose. The domicile, tax status and internal structure of the fund manager will frequently drive the choice of general partner.

At its simplest, the fund manager will itself serve as general partner, with the management and incentive fees earned flowing directly into the fund manager.

The price for this simplicity is that the fund manager accepts unlimited liability for the debts and obligations of the partnership, therefore putting at risk, at least in theory, any other assets or revenue streams which the fund manager may possess or be entitled to in connection with other funds or clients.

Limited partners may lose the benefit of their limited liability if they participate in the management of the partnership. Where this line is ultimately drawn varies significantly from jurisdiction to jurisdiction.

Partnership agreements

The affairs of the partners are governed by the partnership agreement, the scope and contents of which are negotiated by the general and limited partners. This flexibility is one of the principal attractions of partnerships, as opposed to the mandated structure and procedures associated with companies.

The partnership agreement constitutes the partnership and establishes the parameters of the relationships among the limited partners and between the limited partners and the general partner. These agreements can vary widely in their level of detail and breadth of subject matter, depending on the number of investors, any special needs or requirements of particular investors and the complexity of the commercial arrangements involving the general partner and its remuneration.

Next steps

For more information on investment vehicles or how we can help you navigate the issues, please contact:

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