AUDIT • TAX • ADVISORY

Real Estate Matters

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Construction & Real Estate Newsletter

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Now, for tomorrow

Introduction

With 2024 already in full swing, there continues to be quiet optimism that the turbulence and unprecedented challenges SMEs have had to face over the last few years, is making way for a more stable economic environment.

Since the start of the global pandemic, firms have had to contend with inflation hitting a 30-year high, a once-in-a-generation energy crisis, interest rates seeing the steepest series of increases in decades, the pound falling to a record low against the dollar and the outbreak of war in Ukraine and between Israel and Hamas.

Relatively few businesses in the construction and real estate sector will have escaped these unprecedented challenges unscathed, but many have been able to overcome, adapt, and in a number of cases, prosper.

The S&P Global/CIPS UK Purchasing Managers' Index™ indicated a month-on-month contraction in construction activity over the autumn last year and according to business recovery specialists, Begbies Traynor, construction and real estate firms made up a third of companies in 'critical financial distress' in the third quarter of 2023.

HMRC data also shows a month-on-month falls in residential property transactions completed to December 2023, which ended the year 18% down compared to 2022. Likewise, the trade association for the UK's banking industry, UK Finance, has reported that mortgage lending for residential property was 23% lower year on year in 2023. Looking ahead, the Office for Budget Responsibility have predicted an average fall of 4.7% in house prices this year, compared to Zoopla and Rightmove that anticipate a 2% and 1% drop respectively.

While overall levels of real estate investment fell over the year, as investors grappled with flat, or declining asset values and higher borrowing costs - with inflation falling, interest rates stabilising and the housing market in a stronger than anticipated position there has been much more calm heading into the new year. With an election looming, there may also be some beneficial tax breaks on the horizon with could help stimulate growth in the sector.

We expect 2024 will be a stronger year for Build to Rent (BTR), Affordable Housing, Purpose Built Student Accommodation (PBSA) and Retirement accommodation providers as well as those involved in refurbishments, redevelopments, and conversions, which will be key to avoiding an excess of obsolete older assets. The ongoing emphasis on sustainability will continue the shift towards energy efficient assets being the most sought after, further shaping the real estate landscape. Construction firms are also likely to see a modest rebound in the coming year.

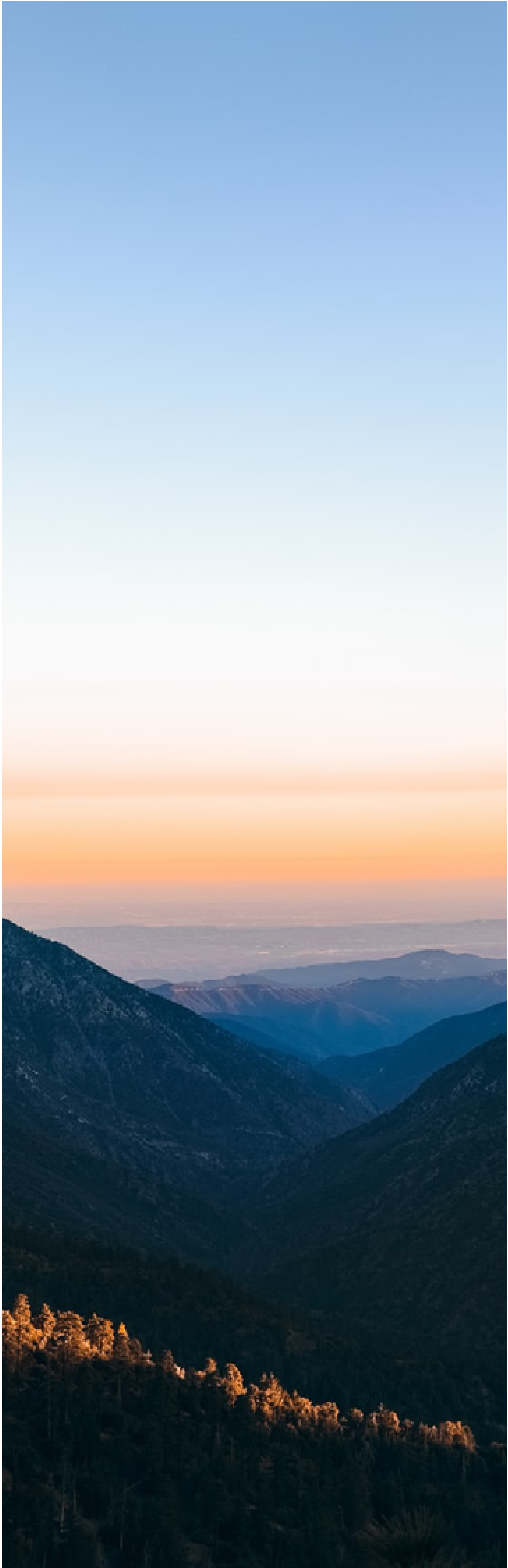
Refinancing may be a challenge for some businesses with loans due to mature in the next year that were based on much lower interest rates and more favourable market conditions, potentially leading to a funding gap. It will be crucial for those businesses to review their position and options in good time.

In this edition of Real Estate Matters, we take a look at several issues which businesses in the construction and real estate sectors should be aware of, such as CIS Gross Payment Status, the Corporate Tax Landscape and associated companies, Residential Property Developer Tax and a whole host of other topics.

As always, we are on hand to provide guidance and support. If you would like further information on any of the issues covered, please get in touch.

Best wishes

The MHA Construction & Real Estate team



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Residential Property Developer Tax – Filing Deadlines Looming

Within the next few months, the majority of companies affected by the Residential Property Developer Tax (RPDT) will be filing their first corporation tax self-assessment returns after its introduction on 1 April 2022.

Some of the issues identified when the legislation was announced are now being addressed practically by the industry. We are working with clients to help them navigate this new tax which, whilst simple in concept, can prove to be complicated in practice for Residential Property (RP) developers who are members of groups and for companies that have an interest in joint venture companies that are themselves RP developers.

RPDT was introduced as part of a building safety package announced in February 2021 to obtain a contribution from the UK's largest residential property developers towards the Government's cost of addressing unsafe cladding following the Grenfell Tower fire tragedy in June 2017. It is intended to raise at least £2bn over a ten-year period. The Government has stated that the tax should be time limited and will be repealed when its aims have been achieved. As the legislation fails to include a sunset clause, the tax is currently open ended.

Key Points:

1. Stand-alone companies and groups will have an allowance of £25 million for every 12 month accounting period to deduct from their RP development profits.
2. To the extend RP development profits exceed £25 million RPDT is levied at the rate of 4%.
3. Where there is a group, the £25m allowance is split between the group entities which are subject to corporation tax.
4. A nominated company will allocate the allowance between relevant group companies by submitting an allocation allowance statement – this notification can either be emailed to HMRC or it can be included as part of the nominated company's corporation tax return (supplementary form CT600N)
5. RPDT profits are calculated using normal corporation tax principles but ignoring:-
   - Profits and losses not relating to the RP development activity (apportioned on a just and reasonable basis);
   - Any amounts of loss relief, group relief or group relief for carried forward losses except for those relating to the RP development activities; or
   - any credits or debits that would otherwise be brought into account in relation to the loan relationship rules.

6 RPDT is payable as if it is corporation tax and will therefore fall due for payment on the same dates. Therefore quarterly instalment payments which full due after 1 April 2022 will need to include an element of RPDT.

7 RPDT is assessed on RP Development profits where the RP developer has (or previously held) an interest in property held as part of that company's stock in trade. Therefore, gains from holding residential property as a long term investment is not within the scope of RPDT.

8 The legislation provides for a form of group relief available from another group company which has a residential property development activity incurring RP development losses for the same period. Relief for brought forward losses (whether arising in the company or surrendered by another group company) will be restricted to 50% of RDPT profits assessable in any year. This restriction might act to significantly defer relief available for losses arising in previous periods.

9 Communal dwellings such as hotels, residential nursing homes or student accommodation are excluded from the definition of residential property for the purposes of calculating RP development profits.

10 An exemption is available for "non-profit housing companies" which are not for profit companies that have been established specifically for the purpose of providing affordable and social housing

RPDT in practice

As interest expenses and finance costs are ignored when calculating RP development profits, it is possible that commercially loss making RP Developers are within the scope of this tax, particularly if they are heavily geared. It should not therefore be assumed that loss making RP developers will have no obligations under RPDT.

Given the rules which state that you have to ignore interest or finance costs when calculating RP development profits, one wonders how or when the loss relief rules would practically be applicable.

Taking into consideration the current economic climate, it is difficult to envisage a scenario whereby a company would be making RP development losses.

Groups have within 12 months after the end of an accounting period to formally inform HMRC of the identity of the nominated member who will make the allocation of the £25 million RP development profit allowance between its group members (allowance allocation statement).

Strict deadlines apply and unless the allocation allowance statement is submitted within 12 months of the end of the accounting period to which it relates, the £25 million RP development profits allowance will be allocated between all group members who are subject to corporation tax equally. As a result of the above, a group company will automatically be allocated part of the RP development profit allowance regardless of whether it actually undertakes residential property development activities.

The nomination and the allowance allocation statement can be submitted as part of a company's corporation tax return.

However, should a group be concerned that they might not file their corporation tax returns in time, a nomination and an allowance allocation statement can be submitted independently of their corporation tax returns by making relevant declarations directly to HMRC via email using rpdtadministration@hmrc.gov.uk.

Once submitted, an allowance allocation statement can be amended up to 24 months after the end of the financial year to which it relates. Thus there would seem to be little downside in ensuring your allowance allocation is submitted early even if a group has not finalised its taxation affairs for a period. As the vast majority of companies maintain an accounting date of 31 December or 31 March, this is a matter they will need to address in the next few months.

The need for apportionment of the profits of a company within scope of RPDT is most likely to arise in the case of mixed-use developments or where residential units in a development are offered for both sale and rent.

What might be considered a just and reasonable basis for apportioning profits will depend on the circumstances. HMRC guidance states that apportionment based on floor area, value or turnover might be appropriate depending upon the circumstances.

Back to Basics – CIS Gross Payment Status

For a subcontractor registered under the construction industry scheme (CIS), obtaining gross payment status can be crucial to maximising cash flow. Without it, a contractor will be obliged to deduct tax from any payments in respect of construction work that a subcontractor undertakes on its behalf.

The rate of the withholding mentioned above is 20% if the subcontractor is registered under CIS. A subcontractor which is a company can offset any tax withheld against monthly payments due under PAYE.

Any excess over PAYE due can be carried forward and credited against the company's corporation tax liability. Any surplus over a company's corporation tax liability can then be reclaimed from HMRC.

If a company does not have sufficient PAYE payments or a corporation tax liability to fully credit CIS deductions suffered, a repayment is not generally automatic and a separate application needs to be made to HMRC.

Where a subcontractor also acts as a contractor, which can happen when a proportion of the construction work is not undertaken by the main subcontractor but is contracted out further, there might not be sufficient PAYE payments to ensure timely recovery of CIS deductions. In which case there could be a real cash flow deficit as such a company will need to await filing of its corporation tax returns before obtaining credit for CIS deductions that it has suffered.

How to qualify for gross payment status.

In order to obtain gross payment status a subcontractor must provide evidence that it meets:

- The business test
- The turnover test
- The compliance test

Gross payment status can be applied for from the outset if it can be proved that a subcontractor meets all of the conditions. Evidence of expected turnover is crucial therefore HMRC might require a copy of a contract to be provided which will quantify the value of construction work that the subcontractor will be providing over the next 12 month period.

The Business Test

The business must be undertaken in the UK using a bank account as the main means of handling cash.

The Turnover Test

For a trade carried on through a company, its net turnover needs to be at least £30,000 multiplied by the number of directors, or £100,000 if this is lower.

The Compliance Test

The company's tax affairs for the previous 12-month period must be up to date. This includes corporation tax returns, PAYE and NIC filings together with CIS returns. (Note whilst VAT compliance is not currently included in this test this is likely to change in the relatively near future).

For companies, the filing requirements also include any obligations enforced upon it by the Companies Act 2006. Additionally, where a company is a 'close company' the compliance record of all of its shareholders may need to be considered.

Maintaining Gross Payment Status and HMRC Reviews

A subcontractor is expected to maintain a good compliance record in the future, therefore should gross payment status be obtained, particular rigour should be applied to its tax filing obligations thereafter.

The subcontractor will be subject to an annual review by HMRC to ascertain whether it is keeping up to date with its compliance obligations. Additionally, any late submission of CIS/PAYE or Corporation Tax returns may trigger a review outside of the annual review period.

If, after a review, a subcontractor loses its gross payment status HMRC must inform it using form CIS 308. Form CIS 308 will advise the subcontractor of the compliance failures that have led to its decision and will give 90 days' notice of gross payment status being removed. It will also inform the subcontractor that it can appeal in writing within 30 days of the notice. The subcontractor can keep its gross payment status until the outcome of the appeal has been decided.

Note that HMRC does make mistakes and so it is always worthwhile talking to a specialist to consider the merits of making an appeal. If gross payment status is revoked, the subcontractor cannot reapply for gross payment status for another 12 months. Once lost gross payment status can be extremely difficult to get back.

There is also a reputational risk because, under the procedures, HMRC will write to all contractors that have made payments to the subcontractor in the last 2 years that it has lost its gross payment status.

This article highlights one small aspect of the CIS rules and the compliance burdens that it creates for those operating in the construction sector as subcontractors. Ultimately obtaining, and maintaining, gross payment status might be the difference between a company being able to operate successfully or failing.

Navigating the New Corporate Tax Landscape: Associated Companies from April 2023

As of 01 April 2023, the landscape for corporate taxation in the UK has undergone a significant shift, with the return of some old rules on associated companies.

This change in legislation, combined with the increase in the main rate of corporation tax (25%, up from 19%), creates new risk and opportunity around how businesses are structured and the management of their tax liabilities. The risk will be of particular concern to businesses with multiple stand-alone companies or multiple groups, as well as to non-resident landlord companies, who could see the amount of tax and the frequency of tax payments increase unless further planning is undertaken.

So, what are the implications of the changes and why should businesses consider changing their group structures in response?

Understanding Associated Companies

Firstly, let's demystify the term 'associated companies'. Broadly speaking, companies are considered associated with each other if one company controls the other, or if both companies are controlled by the same person(s). This control factor, while broad in its scope, is crucial in determining the tax implications for businesses.
The associated companies rules are broader in scope than the prior '51% related companies' rules - which, generally only linked companies in a group – whereas the new rules can link companies in separate groups with common owners.

How Associated Companies Affects Tax

The rate of tax that a company pays is directly linked to its augmented profits. Augmented profits encompass taxable total profits along with certain distribution income. Critically, the corporation tax rate varies based on the level of augmented profits and the thresholds set at £50,000 (the lower limit) and £250,000 (the upper limit). This means that from 1 April 2023:

1. Augmented profits of £50,000 or less are subject to a rate of 19%, known as the 'small profits rate.'
2. Augmented profits ranging from £50,001 to £250,000 incur a 25% rate, with 'marginal relief' available.
3. Augmented profits exceeding £250,000 are taxed at the 'main rate' of 25%.

However, when a company has associated companies, these profit thresholds are divided by the number of associated companies. So, if a company has five associates, the thresholds are divided by six. This division affects not only the tax rates but also factors into any calculations for marginal relief. Therefore, it can significantly alter a company or group's tax liability. The number of associated companies will also impact the thresholds that are relevant for determining Quarterly Instalment Payments, so there is also a potential cash-flow impact in the change of rules.

Prior to 1 April 2023, if an in individual controlled two groups, each consisting of three companies, then each group might only have divided the relevant thresholds by three. This created some tax opportunities, which some businesses would have structured themselves around, that the new rules may eliminate.

Non-resident landlord companies should also be alert to the fact that they are unable to claim marginal relief. This means that they should expect to pay 25% on all profits and, in some cases, it may be prudent consider whether the business structure is still viable given the significant increase in the rate of UK corporation tax.

What is the solution?

Now, let's connect the dots between associated companies and why it might be wise to simplify existing business structures:

1. Reduced tax liability: By consolidating entities or simplifying group structures, you can reduce the number of associates companies and may find yourself positioned in a lower tax bracket. This can directly translate into reduced tax liability, allowing you to retain more of your profits.

2. Simplified compliance: Multiple entities mean multiple layers of administrative complexity. Considering the impact of the associated companies rules is only one factor. Streamlining reduces the burden of compliance, freeing up resources for other endeavours.

3. Eliminating redundant costs: Each entity carries its own set of expenses, from accounting fees to legal costs. Eliminating superfluous entities can help limit expenditure, bolstering results and available cash.

4. Access to tax benefits: Some tax credits, allowances and incentives are tied to specific group structures and might be optimised through a simplified group structure.

5. Efficient planning: A simpler structure can facilitate more efficient tax planning and can be more attractive to outside investors or key management/employees looking to take equity in the business.

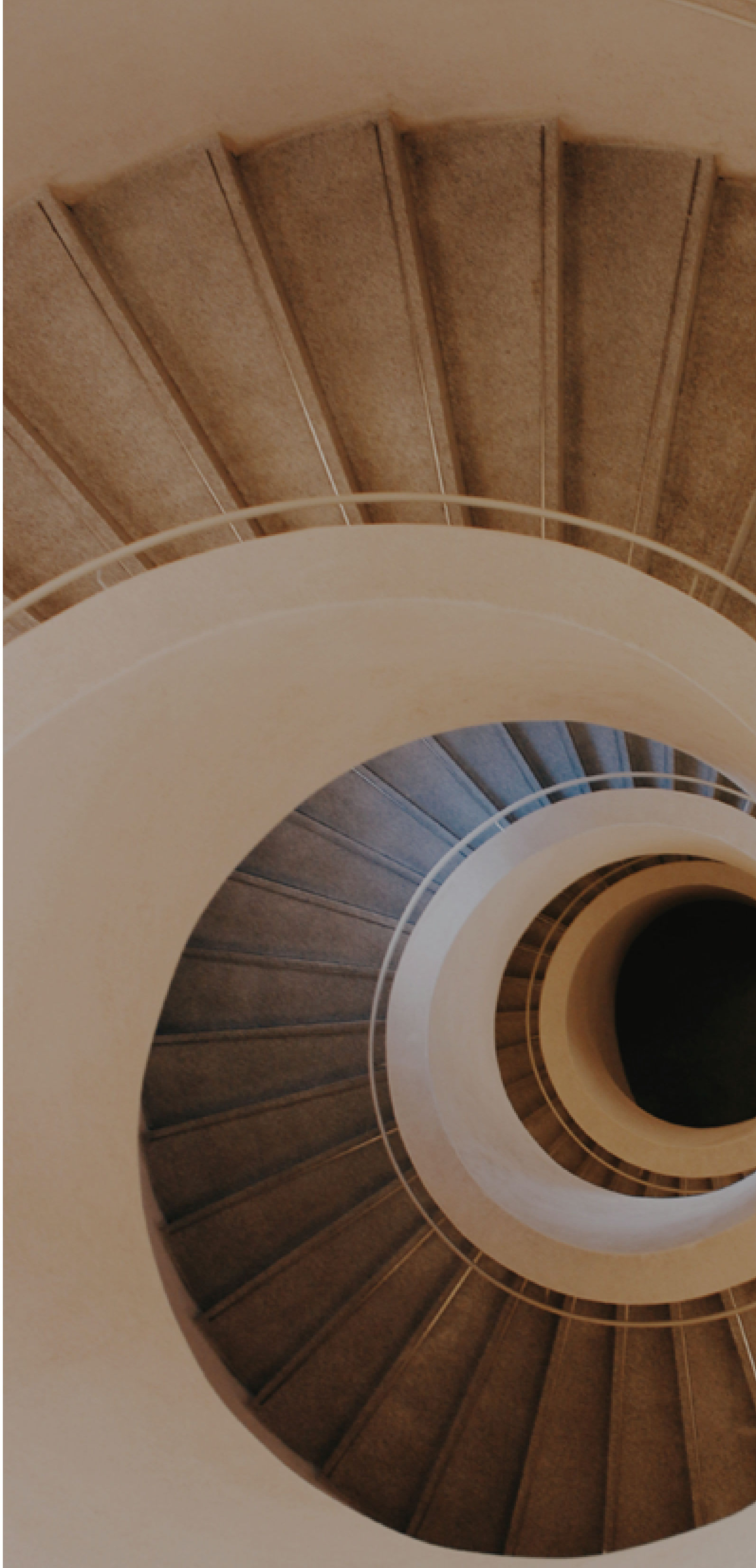
Should you restructure?

For many Owner-Managed Businesses (OMBs), the shift from the 51% related companies rule to the associated companies rule is a pivotal moment. If your existing corporate structure was tailored to the now-defunct 51% rule, or if your structure has not been reviewed since the change to associated companies rules were announced, or if you are a non-resident landlord company, then (re) assessment is likely to be advisable.

Affected OMBs may wish to think about completing:

- **An impact assessment -** to examine the ownership structure of your group to identify associated companies and thus the expected tax thresholds for determining the rate and timing of tax payments.
- **A legal structure check -** to evaluate legal structures. Do they still align with immediate business objectives? For non-resident landlords, is it still commercially necessary to be situated offshore?
- **A review of long-term objectives –** to agree the long-term business goals and shareholder objectives and consider whether the current setup supports these plans.

A tax efficiency evaluation – to pull the above together and assess whether there are opportunities for tax savings. Collaboration with suitably qualified and experienced professionals at each step is vital to ensure that the risks and opportunities are managed.



Conclusion: Seize the Tax-Saving Opportunity

The resurrection of the associated companies rules brings with it a golden opportunity for OMBs to reassess their structure and optimise their tax positions. By simplifying group structures and exploring entity mergers, for example, OMBs might be able to achieve significant tax savings, streamline operations, and prepare their business for a more agile and efficientfuture. In a tax landscape that is always evolving, seizing such opportunities can be hugely impactful for your business's financial health and competitive edge.

Business rating of holiday cottages

From April 2023, new eligibility rules for business rates apply to self-catering properties such as holiday lets in England and Wales. However, these changes create significant challenges due to the complexity and overlap of the rules.

Furnished Holiday Lets (FHLs) which meet the conditions regarding availability and occupation are, for income tax and capital gains tax purposes, treated as if they were a trade, and as such are usually registered for business rates (BR) rather than council tax (CT), enjoying advantageous treatment over normal residential lettings.

The new rules are in response to perceived abuse in some areas, where owners of properties with substantial private use were claiming business usage based on very limited commercial lettings. However, rather than simply applying existing FHL rules to the business rating system, a new set of criteria has been introduced, which is sufficiently different to that which applies for Income Tax purposes that some properties may well comply with one set of rules but not the other.

For example, the rating rules are based on nights of occupation rather than days (i.e. a property let out from Friday evening to Sunday morning would have been let for two nights for the purposes of meeting the business rates definition, but three days for income tax purposes). Moreover, rating decisions will be based on a 31st March period rather than 5th April so there is a further mismatch, particularly if Easter falls over that period.

There is also a difference in terms of the occupation periods, with rating decisions based on an availability of 140 nights, and actual lettings of 70 nights, compared with the qualifying criteria for FHLs of 210 days availability and lettings of 105 days. However, this is not as generous as it sounds, since the special allowances for FHLs such as averaging and "days of grace" do not apply for rating purposes. This effectively means there is no recognition of fluctuations according to the weather, repair cycles or even the timing of Easter each year. (Easter falls at the end of March / start of April so worth checking you will not get caught out in the 2023/24 year. Easter Sunday on 31 March this year).

Where there are multiple cottages with different letting profiles, such as in the case of converted outbuildings on a farm, it is quite possible that some will fail the occupation test for rating purposes whilst the whole block will qualify as FHLs because on average they met the letting conditions.

The rating occupation periods will also be based on the current and previous years of usage, whereas FHLs are effectively self-assessed at the end of each tax year. The transition will be enabled by way of questionnaires sent out by rating authorities during the 2023/4 financial year, but taking effect from 1st April 2023, "to check that the eligibility rules for self-catering properties are met". Failure to return the form or completing it incorrectly could lead to a financial penalty or even prosecution.

It is a complete mystery why we need two sets of measurement to identify the same objective. The complexity of the new procedures and the overlap with the familiar Income Tax rules are likely to lead to considerable confusion. Clients receiving this questionnaire are advised to get in touch to confirm their position and avoid accidental misdeclarations before returning it.

National Insurance on Car Allowances – a refund opportunity?

Employers may be able to claim a refund of National Insurance Contributions (NIC) from HMRC in relation to employee car allowances paid to employees who use their own vehicles for business journeys.

Claims must be supported by detailed data - which may be challenging to analyse, collate, and present - but in the right circumstances that analysis will certainly be justified.

The technical basis

The recent legal case of Laing O'Rourke and Willmott Dixon v HMRC was a joint appeal by the taxpayer employers to the Upper Tribunal. The appeal argued that employee car allowances constitute Relevant Motoring Expenditure for NIC purposes.

The Qualifying Amount is the maximum amount of Relevant Motoring Expenditure an employer can pay NIC-free to an employee, who uses a privately owned vehicle, in respect of motoring expenses.

The Qualifying Amount is calculated by multiplying the number of business miles travelled by the employee by the appropriate HMRC-approved mileage rate.

The employers were successful in their appeal that car allowances do constitute Relevant Motoring Expenditure and HMRC are not appealing the decision further.

Practical application

Under the HMRC rules, employers can reimburse employees who use their own vehicle for work up to 45p per mile for business journeys. The tax-free mileage rate drops to 25p per mile after the first 10,000 business miles, but the 45p rate continues past that level for NIC relief purposes.

Therefore, if an employer reimburses employee business miles at a rate below 45p per mile, there is an element of unused relief on the difference between the HMRC 45p rate and the lower employer rate.

If the same employee has also received a car allowance on which PAYE / NIC has been operated, the unused relief from the mileage reimbursement can be used against the equivalent amount of the car allowance.

The employer NIC and employee NIC paid on that amount can now be claimed as a refund from HMRC. Historical refunds can be claimed going back up to 6 years.

Illustrative refund

An employer has 200 eligible employees who are paid a tax/ NICable car allowance through payroll.

Employees use their own cars for business journeys for which the employer reimburses them at the rate of 20p per mile. The employees each complete 10,000 business miles per tax year. Employer NIC at 13.8% on the unused relief of 25 per mile would be £69,000 for one year and £414,000 over 6 years.

Employee NIC could also be claimed.

Claiming a refund - key factors to be aware of

In light of HMRC not appealing the Laing O'Rourke and Willmott Dixon case, they are likely to scrutinise any NIC

refund claims very closely. Employers will need to demonstrate that the circumstances on which they are basing their claims are as close as possible to those in that case.

The essential supporting factors will be

1. Car allowances are paid to employees in relation to employees using their own vehicles for business purposes
2. Car allowances are paid via the payroll subject to Class 1 NIC
3. The employees are reimbursed for business mileage in their own vehicles at a rate lower than 45p per mile, or are not reimbursed at all

The data analysis required to support the above factors is likely to be extensive.

We anticipate HMRC will not accept estimates based on, say, sample periods – actual figures will be required for each employee and each period.

Next steps

1. Do you have the essential supporting factors above?
2. Can the detailed data necessary to support a claim be extracted from your systems?
3. Consider submitting a protective claim to HMRC
4. Collate and submit your fully supported claim to HMRC
5. Consider changes to policies and systems going forward

MHA's Human Capital Advisory team can help you navigate each of these steps. Please do get in touch if you would like to explore this further.

100% 'track record' mortgages

In May 2023, Skipton Building Society launched the first 100% no-deposit mortgage since 2008. Initially aimed at first-time buyers aged 21 and over that have been renting for at least 12 consecutive months, it was extended to former homeowners that have fallen off the property ladder, in September.

Renters up to date with all rental payments, household bills and other repayment commitments, are able to borrow the equivalent (or less) than they pay in rent at a fixed rate of 5.65% for five years (as at 03.01.24), without a guarantor.

There are a number of risks associated with zero-deposit mortgages, including the potential to fall into negative equity if house prices go down, or finding you have not repaid enough capital to qualify for a standard remortgage at the end of the fixed rate term.

However, lenders have a responsibility to 'Treat Customers Fairly' so mortgage holders can usually complete an internal transfer with their existing lender at the end of the deal without having to provide proof of income or property value.

With the rising cost of renting, this type of mortgage product could be a sensible option for long-term renters prohibited from getting on the property ladder due to the difficulties of raising a deposit.

Building societies are established for the benefit of their members. Because of their ethos and objectives, they will usually have a greater risk appetite and a lower expected rate of return than would otherwise be acceptable to a bank, but relaxing the lending criteria does increase their risk of a higher proportion of non-performing loans in their portfolio and the resulting erosion of the institution's capital arising from increased provisions.

However, having learnt the lessons of Northern Rock's collapse during the global financial crisis in 2008, affordability has been the key focus in determining lending criteria. If people can afford to rent for years (or even decades), in effect paying off their landlord's buy-to-let mortgage, that is compelling evidence that they can be trusted to pay a mortgage on their own homes.

Current Alternatives to 100% mortgages:

Lifetime ISA's (LISAs) – available to open by those aged 18 – 40 to save a deposit, with an annual deposit limit of £4,000, attracting a 25% top-up from the government as well as earning interest. (There are penalties for withdrawing the money, or not using it to buy your first home).

Shared Ownership Schemes – Buy between 25% and 75% of a property's value, paying rent to the developer, or council on the remaining value.

The Mortgage Guarantee Scheme - available until June 2025, the scheme is designed to cover any losses lenders incur in cases of repossession, using government money, where first time buyers have a deposit of at least 5%.

Developer Loans – some new build developers provide loans to help with the cost of buying one of their homes, however they would need to be repaid alongside a mortgage.

Gifted Deposits – a cash gift from a family member or friend, that needs to be declared on any mortgage application to confirm is not a loan, it does not need to be paid back, and does not provide any rights or legal interest in the property being purchased.

Family Deposit Mortgage – family members can borrow against the equity in their home to gift some or all of the money to a family member as a deposit for their home.

Landlords and the current market conditions… A Banking & Finance perspective

2023 was a turbulent year for Landlords with higher mortgage rates putting increased pressure on profit margins and some tricky legislative changes to navigate.

The much talked about shake-up to the rental system in England in the form of the Renters' Reform Bill, if successful, is poised to implement a ban on no-fault evictions and double the notice periods required for rent increases. In Wales, the government implemented new measures to protect renters against eviction in December 2022.

Changes to the capital gains tax allowance drastically reduced the annual exempt amount from £12,300 to £6,000 in April 2023, and will be lowered further to £3,000 from April this year - meaning the potential profitability for landlords selling a property is greatly reduced!

There was some good news though, with the Government set to 'relax the pace' of the EPC deadline for landlords.

As it stood, landlords would have been required to bring their properties up to an EPC level of C by the end of 2025 for new tenancies, and by 2028 for existing tenancies. At present, all rental properties in England and Wales need to have an EPC of at least E in order to be let (unless exempt), which looks likely to remain the case for the foreseeable future. With swathes of BLT properties below EPC level C the cost to many landlords in the current climate, would have been prohibitive.

And then we have Buy-to-let mortgage rates that shot up in 2023 as lenders increased costs in response to the Bank of England raising the base rate. However, despite high mortgage rates, the demand for rental properties remains high and market rents grew by an average of 9.7% according to Zoopla, so it's not all doom & gloom.

So, what are current market conditions on BLT mortgage rates?

The base rate - which plays a pivotal role in determining mortgage rates - currently stands at 5.25%, after the Bank of England raised rates 14 times in a row between December 2021 and August 2023. Before that, the UK base rate had been under 1% for over 13 years.

The Bank of England predicts that UK interest rates will be 4.4% in quarter two of 2024, with rates likely to decrease further to 3.8% in the second quarter of 2025, reaching 3.6% in 2026. However, Landlords with expiring fixed-rate deals secured at much lower rates, could be in for a financial shock when refinancing to a new deal.

The average fixed-rate deal for a two-year BTL mortgage peaked at 6.97% in July 2023 compared to an equivalent average of 2.95% in July 2021 according to data analysts Moneyfacts. Looking at average rates gives us a holistic view of what's happening in the market, but when you're taking out a BLT mortgage, you'll obviously want to get the best deal for your circumstances.

There are still lots of mortgage deals to choose from, with a number of smaller deposit deals - up to 80% loan-to-value (LTV). The best deals all come with substantial upfront fees, which can potentially cost thousands of pounds. So, it's important to look at the overall cost of the mortgage rather than focusing solely on the initial rate when comparing deals.

If you want to discuss a specific issue or simply find out what we have to offer, please get in touch with any member of the Banking & Finance Team at MHA via finsolutions@mha.co.uk or visit www.mha.co.uk/services/advisory/banking-finance.

Can property incorporation help landlords with rising interest rates?

Rising interest rates, together with restricted tax relief for finance costs, have left landlords in a difficult position.

Rises in interest rates have been well documented, with base rates currently standing at 5.25% – the highest level since 2008. Homeowners and Landlords alike have seen their mortgage payments increase significantly. However, given the tax relief restriction on mortgage interest, rising rates are bad news for landlords.

It would therefore be sensible for landlords to assess their tax options and consider how they can look to maximise the value of their assets.

How has the property market changed in recent years?

Prior to 6 April 2017, tax relief was given in full on finance costs (mortgage interest), giving landlords some relief for mortgage repayments. Since then, tax relief on finance costs has been restricted for landlords holding residential property.

As a result of the restrictions, landlords can only claim basic rate income tax relief at 20% on their finance costs (at a maximum), rather than a full deduction of the costs from taxable profits and tax relief at their marginal rates.

Essentially, any income from rental properties is taxable at the individuals standard income rate. If an individual is taxable on his rental profits at a higher rate or additional rates of tax, this would result in an effective 20% or 25% tax charge on notional profits, even if their rental property made a cash loss after finance costs.

How did this work in practice?

The above can be demonstrated in the following illustration.

If we take an individual who has a £4m residential property portfolio, funded by about 60% debt. Their portfolio generates a rental profit before any finance costs of £300,000. Following the interest rate increase, their annual interest costs have increased to around £156,000 per annum. The individual is a UK resident and has no other sources of income.

The individual's cash profit and taxable profit will differ significantly:

Cash Profit

After deducting finance costs, the individual will have a cash/accounting profit for the year of £144,000. The tax liability on the profits (assuming the interest costs were fully deductible) would be £51,003 (based on current income tax rates).

Taxable Profit

With the current restriction of finance costs, the individual would have a taxable profit of £300,000. The tax liability (after deducting the basic rate income tax relief for the finance costs) would be £90,003 – a significant increase of £39,000.

Property Portfolio Incorporations – The Way Forward?

Due to the rising interest rates, a property portfolio incorporation may be the most tax efficient way to proceed – this involves holding the properties in a limited company.

The method of transferring property into a limited company involves the properties being transferred to a company. With any property sales, there may be capital gains tax and stamp duty land tax payable on the transfer of the properties, although the transfers can be structured in a manner to ensure any available reliefs can be claimed.

As the interest restriction does not apply to companies, any finance costs are allowable as a deduction in full against any rental profits. It can, however, prove difficult to re-assign mortgages into a company name, and banks can be hesitant to loan to new companies. This should be discussed with mortgage providers prior to transferring any properties.

A company would be taxable on the rental profits for the year.

From 1st April 2023, the Corporation Tax rates are as follows:

- Businesses with profits of £50,000 or less taxable at 19%.
- Businesses with profits between £50,001 and £250,000 taxable at a marginal (tapered) rate of between 19% and 25% dependent on the profit made based on a formula set by HMRC.
- Businesses that earn profits of £250,001 or above taxable at 25% on the entirety of their profits.

If in the above illustration, the properties were held in a company, the company would have taxable profits of £144,000 for the year, as the finance costs would be an allowable deduction from the profits for the period. The corporation tax payable by the company would be £34.410 – the effective rate of corporation tax would be 23.9%, as the profits fall between £50,000 and £250,000.

Whilst companies are taxable at a lower rate than higher or additional rate taxpayers, and full relief is given for finance costs, it is important to keep in mind there will be tax due on any profits withdrawn from the company by an individual. However, this can be structured to ensure any cash is extracted in the most tax efficient manner and dependent on long term tax planning priorities.

Next steps

Each case needs to be considered on its own merit weighing up the cost of debt, the availability of new finance in a company, the need of any profits, and the likely direction of corporation tax rates in the future.

If you would like some more advice on operating your property business in a more tax efficient manner, please get in touch.

Biodiversity Net Gain

Biodiversity Net Gain (BNG) is an approach to development and land management that aims to contribute to the recovery of nature.

It applies from 12th February 2024 for all major developments (10 or more dwellings or where the site is greater than 0.5 hectares) in the Town and County Planning Act 1990, unless exempt, and will apply to small sites from 2nd April 2024. It will also apply to nationally significant infrastructure projects from late November 2025.

It is a step-change in how the government seeks to deal with ever-decreasing habitat. The UK has lost almost half of its biodiversity since the 1970s, much of which is due to the loss of habitat to commercial farming and construction. 72% of UK land is managed for agriculture, with a further 8% of land being built on. This has led to a steep decline in the abundance of wildlife and nature.

Developers

With increasing demand for residential housing and commercial property, measures to reverse this biodiversity loss is essential. Under the Environment Act 2021, all planning permissions granted in England (with a few exemptions) will have to deliver at least 10% biodiversity net gain from January 2024. BNG will be measured using a statutory biodiversity metric tool and habitats will need to be secured for at least 30 years. This requirement will be in addition to existing habitat and species protections already in place.

Plans will need to show how they will make a net improvement to biodiversity, ultimately leaving the natural environment in a better state than it was before the infrastructure was put in place.

There are 3 ways developers can achieve 10% BNG that must be followed in order of priority:

1. They can enhance and restore biodiversity on-site (within the red line boundary of a development site).
2. If developers can only achieve part of their BNG on-site, they can deliver through a mixture of on-site and off-site. Developers can either make off-site biodiversity gains on their own land outside the development site, or buy off-site biodiversity units on the market.
3. If developers cannot achieve on-site or off-site BNG, they must buy statutory biodiversity credits from the government. This must be a last resort. The government will use the revenue to invest in habitat creation in England.

Points to note:

- Developers can combine all 3 options, but must follow the steps in order.
- The 10% uplift is required whether or not the development impacts existing biodiversity.
- The net gain must be maintained for a minimum of 30 years if making off-site gains, or significant on-site gains.
- Developers must try to avoid loss of biodiverse habitat when doing development work

Landowners and land managers

'Off-site' BNG has created a market for rural landowners to sell biodiversity units to developers, which would also need to meet the statutory biodiversity metric and be maintained for a minimum of 30 years.

This does bring some complications for the landowner, as the BNG sites will need to be formally registered with Natural England , managed, monitored, and reported on for the duration of the net gain agreement, with responsibilities set out in a legal agreement.

Calculating the value

The government have provided a statutory biodiversity metric tool, which supersedes the Natural England's Biodiversity Metric 4.0 (Guidance on how to copy over from previous versions of the biodiversity metric and the changes since 4.0 will be published in due course). It is an accounting tool that can be used by ecologists for the purposes of calculating BNG, which uses habitats as a proxy for biodiversity and compares the habitat found on a site before and after development based on habitat size, type, condition, distinctiveness, and location.

Calculating the value of BNG units

Prices for BNG units will be agreed between landowners and developers, so will likely reflect the local market and depend on factors such as the type of biodiversity that needs to be compensated and the cost of land. Market analysis carried out for Defra in 2021 by Economics for the Environment estimated that mandatory BNG could generate demand for 6,200 off-site units per annum, with a market value of £135m (an average of £22,000 per unit). Other forecasts suggest anywhere between £8,000 to £30,000 per unit.

Considerations

For the developer, they will need to ensure that the BNG uplift can be delivered in line with the proposal in the planning documents. 30 years is a long time and therefore the developers may seek to use an intermediary to manage the BNG sites over this period.

Critically for developers, they will be able to benefit from making use of excess BNG units generated from an existing site and using this excess on new sites.

Habitat banks are being used as a locator tool for developers to help them find local BNG units and are looking to provide management of these schemes for the develop and the landowners.

In terms of the landowners, they may be entering into a lease which will have potential income and capital gain tax considerations. There are opportunities for land owners to consider how best to structure the creation and sale of units generated. They may also be taking responsibility for the continued maintenance of the land in line with the prescribed management plan. There remains uncertainty over the Inheritance tax treatment of land within a BNG scheme – currently landowners would usually benefit from Agricultural Property Relief so the potential loss of this relief may make it an unattractive option. The latest budget confirmed that a potential expansion of agricultural property relief to cover certain types of environmental land management is underway, and we would hope this would provide some clarity for those concerned. How long this may take, is unknown.

How can MHA help

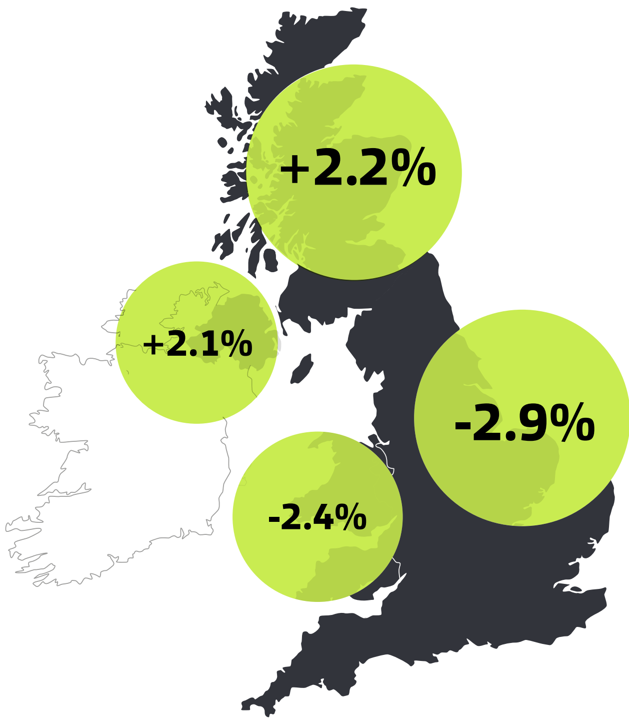
If you are a developer or a landowner, there are business opportunities that come with this change, which need further consideration. Our Construction & Real Estate team work closely with our Agriculture team, so can provide the specialist support to help you navigate the new rules and maximise any opportunities.

House Prices!!

The latest house price data was published on 17th January 2024 by HM Land Registry on GOV.UK which provides data up to November 2023. It reveals that average house prices in the UK decreased by 2.1% over the year to November 23, down from a decrease of 1.3% in the 12 months to October 2023. The average price of a house now stands at £285,000 in November 2023, which was £6,000 lower than 12 months ago.

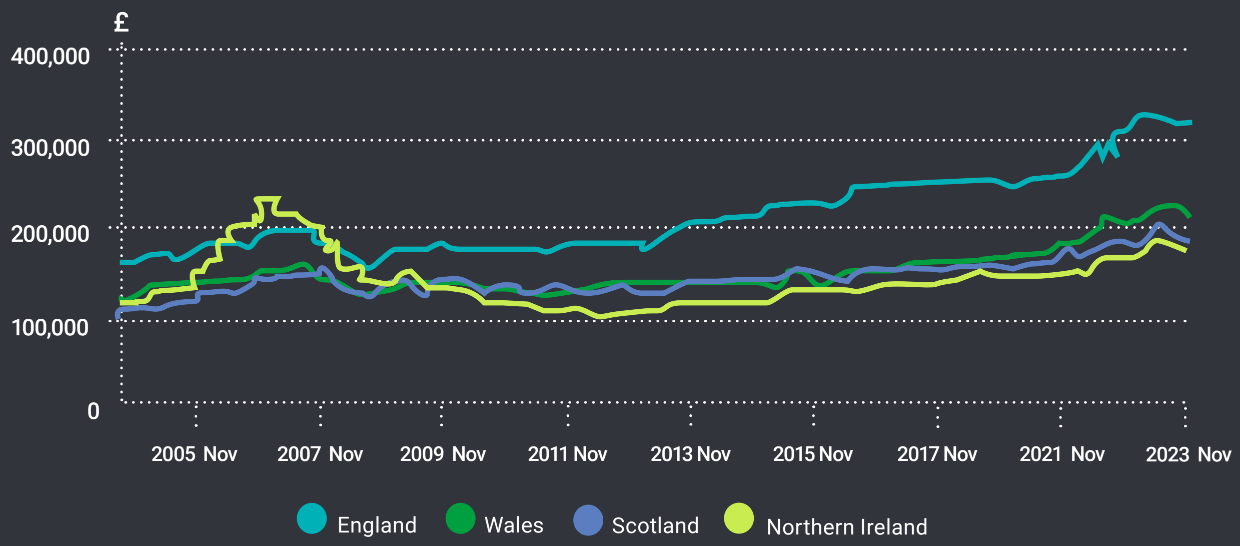
Average house prices across the UK

- England decreased by 2.9% over the year to November 2023, with the average house price in England now at £302,000.
- The average house price in Scotland increased by 2.2% over the year to November 2023, with the average house price in Scotland now at £194,000.
- Wales decreased by 2.4% over the year to November 2023, with the average house price in Wales now at £213,000, £5,000 lower than 12 months ago.
- Northern Ireland remains the cheapest UK country to purchase a property in, with the average house price at £180,000, having increased by 2.1% over the year to October 2023.



England house prices remain the highest in the UK

Average house price by country, UK, January 2005 to October 2023



Regional variation

- The North East continues to have the lowest average house price of all English regions, at £160,000.
- London's average house prices remain the most expensive of any region in the UK, with an average price of £505,000, but was also the region with the lowest annual house price inflation, with average prices decreasing by 6% in the 12 months to November 2023.

All English regions saw an annual price fall

All dwellings annual house price percentage change, by English region, 12 months to November 2023

News bites

1 Mortgage time bomb

Figures from the Financial Conduct Authority show that around 1.5 million homeowners will come to the end of fixed rate mortgage deals in 2024, joining the 1.4 million that came to the end of their deals in 2023. Higher rates, and in turn higher repayments have come in like a wrecking ball for many; whether paying their own mortgage or paying rent on a landlords mortgaged property. These higher payments are beginning to feed into all areas of the housing market and wider economy. According to the English Housing Survey 2021 to 2022, 7.1 million households (approx. 30%) in England are owned with a mortgage.

2 L&G cease production of modular homes

The insurance firm Legal & General (L&G) have announced they will "reduce business activity" and cease production of modular homes at their factory in Yorkshire, having been unable to secure the necessary scale or pipeline to make the current [business] model work. Bill Hughes, chair of L&G Modular Homes, said: "Legal & General is proud of what we have achieved in bringing forward a new approach to construction through our factory. However, without the necessary scale of pipeline it is not sustainable to continue producing more modules. We are therefore reluctantly proposing to reduce business activity and cease production of new modules at the factory."

3 Housing Infrastructure Fund largely unspent

The UK government's Housing Infrastructure Fund, aimed at addressing the housing shortage, remains largely untapped, with over two-thirds of the £4.2bn fund unspent since its 2017 launch. Intended to fund critical infrastructure for housebuilding, only £1.3bn, or about 31%, has been used to date, as revealed in a recent Freedom of Information request by local government researcher Jack Shaw. The government confirmed that less than 10% of the promised homes have started construction, leading to a revision of the delivery target from 340,000 to 270,000 homes. The UK falls significantly short of its annual target, adding only 232,820 new dwellings last year.

4 Construction firm Payment Practices accounting disclosures

To help combat poor payment practices to support small businesses, Business Secretary Kemi Badenoch has announced proposals for new disclosure requirements for major construction companies covering contractors' retention policies, release procedures, and payment timelines. Holding retention money is an established incentive for construction suppliers to mitigate against defects and offers "insurance" in case contractors do not complete work or return to fix any issues.

However, determining what proportion of late and non-payment of retention monies is for genuine reasons, or unjustified is challenging. Late and non-payment is more prevalent further down the supply chain, which could reflect higher instance of defects or work more frequently overrunning on tier 2 and tier 3 contracts; or could be that larger businesses further up the supply chain are systematically obtaining credit from the typically smaller firms they contract with.

Construction News reports that the proposed rules will capture contractors' retention policies, standard terms, and fund release approach as well as average days for retention payments post completion and contractual-defects-liability period. It will also include the percentage of payments within various time frames, percentage of overdue retention payments and average value of retentions per contract as a percentage of the contract value. A separate government response notes that Whitehall will collaborate with the industry to determine the final format for statistical reporting on retentions.

5 Government procurement not fit for promoting MMC

Contractor representatives informed a Parliamentary committee that the cashflow model employed in government procurement does not effectively support modern methods of construction (MMC). The House of Lords' Built Environment Committee, investigating sector issues amid high-profile business failures, heard from Laing O'Rourke's group technical director, Andrew Wolstenholme, who emphasised that the public sector's existing "low-cost, competitive-tender system" is was not fit for promoting MMC.

6 Housing benefit boost for private renters

Jeremy Hunt confirmed in the autumn statement that he would unfreeze the local housing allowance (LHA) for private renters, which caps on the amount of housing benefit that tenants in the private rented sector can receive. The benefit was designed to cover rental costs in the cheapest 30% of properties in an area, but would now be increased to the 30th percentile of local market rental rates to cover the full rent for the cheapest 30% of rental properties.

7 Council Tax Rises

The majority of local authorities in England are expected to raise council tax from 1st April 2024 by the maximum amount allowed without triggering a referendum.

Those with social care duties can raise it by 5%, while others can put it up by 3%. However, Birmingham and Nottingham City Council may see larger rises after filing for bankruptcy in 2023.

The Scottish Government has confirmed council tax for households in Scotland will be frozen at current levels until April 2025.

The Welsh government has been consulting on a range of potential approaches to council tax reform, but in the meantime has urged local authorities to keep any council tax rises for 2024/25 at a "reasonable level", saying it would use its powers to cap council tax if needed.

Northern Ireland is not covered by the council tax system - it uses a domestic rating system. Bills are calculated according to property values.

8 Over 65's are sitting on 10 million spare bedrooms

New research from Zoopla has found that 40% of homeowners over the age of 65 live in homes 'larger than they need'. It revealed that 9 in 10 over 65's either live alone or as a couple, yet 71% live in homes with at least 3 bedrooms. The cost and stress of moving, as well as the emotional attachment to the family home are cited as the key blocks to downsizing.

There is a large disparity between the supply and demand for 3-bedroom family homes. However, there is very little financial incentive for older homeowners to downsize and a lack of suitable alternative properties in the area and communities they want to remain part of. Bungalows close to local amenities are in short supply and most retirement homes come at a premium, with large service charges and hefty 'exit fees'. Saga has long campaigned for older people to be able to have one move free from stamp duty if they downsize, with economists estimate that this could bring an additional 111,000 family homes to the market. Other tax incentives could also play a role in encouraging more people to downsize.

9 Hoarding land

UK housebuilders are retaining land that could potentially yield over a million homes according to the Competition & Markets Authority (CMA). Their investigation found that developers are holding 658,000 plots in long-term landbanks, with a further 522,000 in short-term landbanks with planning permission. Critics allege that this practice aims to maintain high house prices, while developers contend it's a response to the slow planning system. The CMA is closely examining how these landbanks influence competition and the housing market, with a comprehensive report anticipated in February.

10 Are Landlords selling up?

Analysis by the estate agent Hamptons indicates that private landlords are projected to have sold nearly 300,000 more homes than they acquired between 2016 and the end of 2023. The number of buy-to-lets sold by the end of 2023 is expected to have been in the region of 140,000. Although this represents a decline of 53,000 from 2022 and 62,000 from 2021, the overall trend suggests a net reduction in the landlords' property portfolio over the period.

11 Another new housing minister appointed!

Lee Rowley, the MP for North East Derbyshire, has returned to the role of Housing Minister, making him the 16th Person to hold the position since 2010. The previous housing minister, Rachel Maclean, was sacked the day before she was due to introduce the Renters Reform Bill in November last year.

12 EG Group confirms deal with Tesla

EG Group have announced that they have agreed a deal to acquire Tesla's latest ultra-fast charging units for EG's rapidly growing evpoint business across the UK and Europe. Capable of charging approximately 80% of a vehicle's battery in just 20 minutes, these charging outlets aim to contribute to the growing infrastructure supporting EV usage.

13 Housebuilding to fall to lowest point since financial crisis

A report by former Treasury economist Chris Walker, in collaboration with Liverpool University, foresees a sharp decline in private home construction in England. The expected decrease from 249,100 completed homes last year to 151,000 in 2023 is the lowest since the financial crisis. New housing starts are also predicted to fall by nearly 50% within two years. The report identifies the lack of a national housing strategy as a critical issue, along with the scrapping of housebuilding targets by Levelling Up Secretary Michael Gove. Taxes on builders for hazardous cladding replacement are also cited as a contributing factor.

The study reveals next year's anticipated completions would be 87,000 fewer than two years prior and 166,000 short of the government's housebuilding target. In the private sector, home starts are forecasted to decline from 144,000 last year to 70,400, representing the lowest figures since the 2008 financial crash.

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We are MHA

MHA is the UK independent member of Baker Tilly International, ranked 9th globally. We provide premier accounting, assurance, tax and specialist business advice worldwide, drawing on internationally recognised industry and service line experts in 145 countries.

Our Sector Approach

We have a wealth of experience in providing professional advice to a diverse range of clients within the property and real estate arena, including commercial and residential investment, facilities management, developers, and property-related service providers.

MHA allows clients to benefit from in depth sector knowledge in addition to specialist accountancy services and expert business advice. Construction & Real Estate is a key sector for MHA, and our industry experts understand the challenges and opportunities within the sector. Because it's such an important sector for us, we invest considerable time, money and resources to ensure our expertise and services are unparalleled.

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128
Partners

23
Offices nationwide

£142
Million turnover

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