What is the future for UK real estate after Coronavirus and Brexit?

Richard Anthony, Head of Real Assets – Jersey, outlines some of the recent proposals designed to lessen the impact of Brexit and COVID-19

Although the world is justifiably preoccupied with the ‘C’ word (Coronavirus) right now, the UK cannot afford to forget that before the pandemic turned everything upside down, our main concern was the ‘B’ word (Brexit), which is very much still with us. With that in mind, it’s worth summarising the latest political, regulatory and investment developments aimed at keeping the UK on an upward growth trajectory once Brexit is delivered.

Brexit – the current state of play

On 31 January 2020, the UK’s withdrawal agreement from the European Union (EU) took effect. From that time on, the UK will no longer be an EU member state and loses its voting rights within the European Parliament. This date was also the start of a transition period, which is designed to help businesses and citizens to adapt, which is scheduled to end on 31 December 2020. During this 11-month period, the UK will remain in both the EU customs union and the single market. However, the transition period will also allow for trade negotiations between the UK and other countries to commence, because such negotiations could not happen while the UK had veto rights within the EU.

Will an extension be sought?

The transition period can be extended before 30 June, however as reported in the press, the UK government does not want to seek an extension to the transition period. Brexit negotiators also have to determine access rights to UK fishing waters and access to the UK/EU financial services market by 1 July. This means that the next two months will be an essential time as to the direction of the future relationship between Britain and the EU.

Given this pressing backdrop, there is no doubt that there is a much stronger will from all the key government bodies including HM Treasury, HMRC and the Financial Conduct Authority (FCA) to strengthen the UK's competitive position, particularly across financial services. There is also a strong desire to encourage increased investment into the UK, particularly within critical areas such as real estate and infrastructure, as these are seen as crucial to increasing economic activity, creating employment and delivering growth and strengthening the UK's competitive position post-Brexit.

Proposed new onshore fund structure

In essence, there are three core initiatives currently being proposed that are anticipated to impact the real estate and broader funds industry. The first initiative is a consultation on onshore professional funds. Back in March, the Investment Association (IA) and the Association of Real Estate Funds (AREF) set out a blueprint for a new fund structure called the Professional Investor Fund (PIF).

The proposed PIF would mean the creation of a UK-based alternative that, in the words of the IA, would "allow pension funds and professional investors to invest in real estate and infrastructure through an unlisted, tax-transparent fund structure" with tradeable units, which currently does not exist in the UK and often such funds are structured outside the UK. In practice, this would eliminate a significant structural gap within the UK fund industry.

As part of the report sent to the Treasury Asset Management Taskforce, the PIF falls within three proposals for onshore professional funds, including a new UK unauthorised partnership, unauthorised corporate vehicle and the PIF which is structured as an unauthorised contractual scheme. It was subsequently announced in the recent March budget that the Treasury would review the UK's fund regime during 2020.

Holding vehicles

The second key initiative to be aware of is the HM Treasury consultation published in March, which looks at the tax treatment of asset holding companies within alternative fund structures. The aim of the consultation – is to explore the UK's attractiveness as a location for intermediate entities through which investors and alternative funds such as real estate, infrastructure, credit and private equity hold assets.

The aim of the consultation is to explore the potential of making certain tax, legislative or regulatory changes to facilitate strengthening the UK funds regime while maintaining existing levels of taxable income / gains.

Taxation

The third initiative relates to a review of direct and indirect tax for asset managers / funds including VAT charges on fund management fees. Again, this measure is aimed at further strengthening the attractiveness of the UK as a base for asset management.

What are the implications for UK real estate?

Clearly efforts are being made to increase the flow of capital into UK real estate. But as a private markets specialist fund administrator and service provider to many well-established property companies, we think now is the time to consider where this future investment might be focused.

Of course, the additional impact COVID-19 also needs to be considered. We expect that defensive and resilient real estate sectors that are most capable of demonstrating income stability over the long term – beyond the coronavirus crisis and post-Brexit – will attract the attention from investors.

In this respect, the logistics sector has found itself at the forefront of the response to the coronavirus crisis, as society collectively changes the way it purchases, stores and delivers goods. We expect this trend to continue.

Another trend likely to continue beyond the coronavirus crisis is the increased activity within the care home space. The case for more investment into care homes is clear: the UK has an ageing population that needs higher levels of care and better-quality housing. From an investment perspective, it’s also worth noting that the care home space is an asset class that typically has a long lease (and therefore steady income stream) profile.

Opportunities within the residential property sector

At the Aztec Group, we also provide administrative services to institutional clients that invest in a range of residential real estate investment strategies. While the commercial real estate sector continues to face several headwinds as a result of the coronavirus pandemic, the outlook for residential real estate appears far more positive.

Press coverage is too often distracted by talk of falling house prices, but residential property accounts for a considerable proportion of the UK real estate market. It also historically outperforms commercial property during downturns. Notably, several new funds within the affordable and social housing space have come to market recently – which presents an enormous opportunity given the demand for investments that offer reliable, sustainable income and socially responsible investment. Traditionally, it has been hard to find investments that provide the scale that institutional investors require, but this now looks like changing, and we expect the number of funds launched in this area to increase in the months ahead.

Summary: proposals offer much to be encouraged about

Just a few short months ago, no-one would have predicted the UK economy would be facing two major hurdles, in the shape of EU withdrawal and coping with the impact of a global pandemic. Given this exceptional backdrop, it’s important to focus on the positives and encouraging to see new growth initiatives being debated. Should some or all these three proposals be successfully adopted, we can expect significant capital and investment activity in the UK, particularly within real estate and other private market asset classes.