Purpose Built Student Accommodation (PBSA) - Real Estate Tax Update from E3 Consulting

Leading property tax specialist Rupert Guppy, Senior Tax Surveyor with E3 Consulting, sets out the attractive tax benefits helping to drive investment into one of the most popular property sectors - the Purpose Built Student Accommodation (PBSA) sector.

With good reason – as this particular asset class is expected to attract record levels of investment – up to £5.7bn this year, according to Property Week's November 2015 Student Accommodation Supplement.

Optimising the available tax relief is a vital component of effective asset management, and doing so can result in a significantly improved yield on the property investment; increasing the owner's after tax profit. However, there are several key issues to consider as part of any PBSA project – whether it be a new development, refurbishment or acquisition of an existing building. Substantial tax savings are available, however in order to achieve the best results possible it is important to consider the issues at an early stage by seeking expert advice.

Capital Allowances – New Build/Refurbishment

Most PBSA schemes can benefit from significant levels of capital allowances, which are a valuable form of tax relief available to UK tax-payers against capital expenditure on certain assets, in lieu of depreciation which is not allowable for tax purposes. Assets qualifying for capital allowances include – electrical installations, security equipment, heating and ventilation systems – lifts and IT, Data and telecommunications equipment as well as sanitary fittings and built in furniture – desks and wardrobes, kitchen cabinets, etc.

However, a key restriction concerning Capital Allowances is that no allowances are available for expenditure on assets used in a "dwelling". This issue is crucial to PBSA schemes and can have a major impact on the potential levels of tax savings achievable. HMRC has published their own guidance on this point, however this is only *their* interpretation of the capital allowances legislation – it may not be relevant in all cases, and so each claim is dependent on the specific facts of the individual project, its design and specification.

Over recent years, there has been a shift in the design away from traditional halls of residence (bedrooms off a long corridor) towards a more contemporary style of student living. The evolution of 'cluster flats' and more bespoke accommodation has resulted in HMRC's change of view regarding the boundary between 'institutional student accommodation' and 'dwellings'. HMRC now contend that a cluster flat, with individual bedrooms arranged around common kitchen and living space, constitutes a dwelling, meaning capital allowances are only available in respect of the communal areas such as stair cores, corridors leading to flats and any shared lounges, or open bar/leisure provision within the property. Despite this, it may still be possible to substantiate a valuable claim for capital allowances on PBSA incorporating cluster flats subject to a number of other factors. HMRC's published guidance remains untested by the courts and so, potentially not binding on tax-payers as the legislation, upon which the tax relief is based, is certainly less prescriptive.

An additional area of opportunity for tax savings on both new build projects and refurbishments is by specifying environmentally beneficial assets that qualifying for Enhanced Capital Allowances (ECAs). ECA eligible assets attract 100% tax relief in the first year, and can even trigger a payable tax credit if a tax-payer's ECA claim creates losses, for surrender. Examples of ECA eligible assets include; solar thermal installations, LED lighting, air conditioning installations, pipework insulation, motors/drives and low water sanitaryware – all very relevant to PBSA schemes. Whilst clients often require their designers to look at lifecycle efficiencies; to benefit from ECAs the assets must either be listed as part of the Energy/Water Technology Lists, or meet specified performance criteria – as not all energy or water efficient assets attract 100% tax relief. In order to ensure the correct assets are specified, it is important to consider ECAs as early as possible in the project design phase – even including an undertaking in the contract for ECA assets to be installed and the contractor and sub-contractors to provide relevant supporting data.

Capital Allowances – Acquisitions

Capital allowances can be equally valuable to the acquisition of second-hand buildings – either a completed development or an existing commercial building prior to conversion into Student Accommodation. In some instances up to 35% of the purchase price may be attributable to capital allowances eligible assets. Identifying and valuing these assets is a complicated process, with the complexity further exacerbated by the Capital Allowances New Fixtures Rules – which came fully into force in April 2014. As a result of this new convoluted legislation, it is vital that capital allowances are addressed early, ideally at the point of sale, or within 2 years. Failure to correctly undertake the transaction due diligence can result in any allowances defaulting to nil and so being lost, for both current and future owners. These multifarious tax rules are poorly understood by non-specialists and we are now seeing increasing levels of litigation where the New Fixture Rules have not adequately been considered within the sale and purchase agreement.

E3 Consulting is currently advising on a number of acquisitions of properties in this sector – both existing PBSA schemes as well as commercial buildings intended for conversion into Student Accommodation. Due to the complexity of the New Fixtures Rules, the capital allowances available on these transactions has ranged from 6% of the purchase price to 26% - in the case of one project, Capital Allowances of approximately one million pounds may have been lost due to the client's solicitor's failure to address the Capital Allowances with the vendor when the transaction was going ahead.

VAT

Although the standard rate of VAT is 20%, there is a range of reliefs available that apply to PBSA projects that can achieve a reduced rate of 5% or even a 0% rating, if addressed early in the project. This can deliver a real positive boost to cash flow – particularly where any VAT suffered is irrecoverable. Successful mitigation of VAT by achieving a lower rating needs early engagement and open dialogue with the suppliers/contractors involved in the project; as it is the contractors and sub-contractors who will be responsible for charging VAT at the appropriate rate, standard, reduced or zero. E3 Consulting has advised on a number of projects where both reduced (5%) or Zero rating has been achieved, including providing line by line analysis of project costs to ensure accurate VAT treatment of all project components, with full substantiation in the event of a query by HMRC.

Community Infrastructure Levy (CIL)

CIL was introduced via the Planning Act 2008 and has been slowly been adopted by various Local Planning Authorities (LPAs) across England and Wales to supplement and since April 2015 replace certain aspects of s.106 contributions in supporting PBSA projects. Unfortunately, despite its original inception being about 'standardising' or removing the idiosyncrasies of LPAs for a more uniform approach so developers know where they are – CIL in reality is set at different rates and applicable to different classes of use – by each and every LPA. This results in some

PBSA schemes being exempt from CIL, whilst others, such as those in Southampton, for example, are being charged at £70/m^2.

Case Study - £13 million PBSA block

The best illustration of the value that capital allowances can add to a PBSA scheme is through a recent case study. The client acquired an existing PBSA block in a large university town from a developer for a price of £13 million. The building at the time had ground floor retail units, but our client subsequently converted this area into additional student flats at a cost of over £2 million. The client's accountant recognised that optimising the capital allowances was "beyond their levels of expertise" and so E3 Consulting was appointed and subsequently identified over £5 million of allowances across both the original purchase and subsequent ground floor conversion works. The corresponding tax savings over time will be in excess of £1 million, an outcome the client was delighted with stating –"E3 delivered a better than expected outcome, in good time and on budget, we can only recommend them".

E3 Consulting is an award winning independent firm of Chartered Surveyors specialising in Property Taxation. We provide specialist property tax advice to owners, investors and occupiers of real estate in the UK and internationally from our offices in Southampton and London. In the last few years, our team has collectively advised on PBSA projects valued in excess of £165m, successfully identifying over £41m of tax relief. Contact us now to see how we can help you optimise the tax savings available in your current, past or future projects.

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