

Using Pension Schemes to buy Commercial Property



The purchase of commercial and other property via pensions schemes has been a growing market for several years now.

The signs of a slowdown in commercial property may make the use of the more tax efficient pensions scheme investment route more appealing to those considering investing.

In addition the government has recently announced possible changes to the provisions governing Self Invested Personal Pensions (SIPP) which could fuel further growth in this market. It therefore seems an apposite time to revisit the advantages and disadvantages to using a pensions scheme to invest in property.

Types of scheme

There are various schemes which may invest in commercial property. There are the large pension investment funds run by providers which invest in multiple large properties and thereafter allow investors to purchase units or shares in their fund, effectively property funds.

There are also larger occupational schemes which invest in property directly or which invest into property funds,. At the more personal end of the scale are SIPPs and Small Self Administered Schemes (SSASs) which invest in specific properties, often connected with the individuals or groups business. This update will concentrate on the more personal end of the market, SIPPs and SSASs.

SSAS

A small self administered scheme or SSAS is a small occupational scheme, which is set up normally by controlling directors of small companies and by professional partnerships. The key attraction of an SSAS is that they give substantial control of the investments and running of the scheme to the trustees who are usually the same director or professionals who set the scheme up and who are investing in it. There are restrictions on the controls exercised.

One advantage of SSAS over SIPP is simply the control it allows. There is not the same reliance on outside trustees or providers as with SIPP, those outside trustees there are tend to be hands off. A SSAS is potentially more appropriate for small family run businesses who wish to retain more control.

SIPP

A Self Invested Personal Pension Scheme or SIPP is similar in many ways to a normal personal pensions plan. The chief difference is the type of assets it can invest in and who controls the investment choices. The plan member can either choose to retain direct control of the investment strategy or delegate this to a professional such as a fund manager. Many SIPPs are written under trust. The chief issue with a SIPPs is that they are not all the same and any comments applied to them must be checked against the actual details of the plan purchased. Different providers have substantially different SIPPs.

Property Investment

Both SSASs and SIPPs have the ability to invest in property. The advantage of doing so is simply that it is tax efficient. It also allows the pension assets to support the business.

There are restrictions around these investments.

An SSASs has restrictions on the type of properties in which it can invest. Residential property is now banned since 2006 unless it is

incidental or was held prior to 6th April 2006 (and no enhancements or improvements are carried out). Normally the scheme will purchase the sponsoring companies place of business. The sponsoring company will then be required to pay a commercial rent and all transactions must be at arm's length and on a commercial basis. There are also issues around ownership by connected parties that must be considered. You should always take legal advice before proceeding.

A SIPP can also invest in commercial property and is also subject to restrictions. Borrowing is limited to 50% of the scheme's assets (prior to A-Day the percentage was higher and some older SIPP's may have a higher percentage still invested in property). All costs of buying the property must be met by the pension. All transactions must be arms length and for commercial rates.

Tax Efficiency

Buying property via your scheme is tax efficient simply because tax relief is claimable on pensions contributions. For instance if you pay in £80,000 to your pension scheme, tax relief will make this £100,000 available for investment. You should note that there are limits on how much can be contributed to a scheme each year. Certain providers also have additional rules which could limit the amount available for property investment.

Recent Developments

The government as mentioned previously is considering allowing investment of protected rights in SIPP. At least one SIPP on the market already claims to be able to accept protected rights due to its unique governance structure. The proposals will now allow even greater funds to be placed into SIPP's increasing the amount available for investment in commercial property. It is estimated this could liberate between £75 - £100 billion in protected rights.

Pitfalls

There are areas that should be considered when using a SSAS or SIPP to purchase property:

- Ownership

You do not own the property. It is owned by the pension scheme and therefore subject to pensions law regulation. You cannot decide to do things to the property without the agreement of the trustees. The trustees will sometimes not agree with your proposals if they do not add value to the property. This problem is more likely to exist in a SIPP than SSAS. SIPP's are more likely to have trustees not directly connected with the person whose pension scheme it is. SSAS members are usually more able to influence who becomes a trustee.

- Rent

For a company or individual to continue using the property they will

be required to pay commercial rent to the scheme. Failure to do so may leave the scheme trustees with no choice but to take action against the company. This may seem surprising but there are several precedents where the pension scheme has been forced to repossess the property and evict the company or partnership. This is due to the fact that the trustee's primary duty is to the pension scheme. If no rent is being received then there is no income. The member as an individual will therefore have a pension which is diminishing in value. What will happen in each case will be decided in that case but failure to pay the commercial rent could result in dire consequences. This issue is more likely to arise with a SIPP.

- Tax Exempt Status

For SSAS in particular, breaches of the rules surrounding a SSAS can result in a loss of tax exempt status with the result that the scheme will require to find the wherewithal to pay the tax. This has in the past resulted in the bankruptcy of the scheme, the trustees and even the company.

- Transfer Values

For SSAS transfer values are a serious issue. If the scheme is effectively invested in the company's property and one member chooses to leave taking a transfer value with them, how is this to be funded? It may not be the best time to sell the property back to the company and there may be no other cash assets.

- Taking your pension

If your scheme is invested in property and in some cases that is effectively the only investment, how easily realisable will your pension be when you decide to take it? An example would be where you run a business from the property in question, you choose to retire, a local rival makes you a good offer for your business but is not interested in the property, the local property market may not have a requirement for the type of premises held by your scheme, how do you sell the property without a loss thus reducing your pension pot? The question of how to liquefy your property asset to allow you to retire could become an issue.

Conclusion

We will advise you should the governments proposed changes to SIPP regulation proceed. We would strongly recommend taking the appropriate advice before proceeding to purchase property via a pension scheme. We are able to provide legal advice on the structure and nature of any pension and would suggest a proper knowledge of one of your largest investments.

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