

## SIPPS: A Guide to Property Purchase and Lease

*This information is for use of independent/financial advisers and should not be relied upon by the general public*

**The purpose of this guide is to set out a general basis for the purchasing and leasing of property under an MW SIPP. Whilst we have tried to cover most eventualities, the complexity of property transactions is such that it is not possible to cover every possibility.**

### **Why invest in property?**

A SIPP allows you the option of investing in property. This can be the outright purchase or with the assistance of a commercial mortgage. The concept is simple and has all the advantages of tax free growth - no income or capital gains tax. It is vital, however, that property investment is handled with expertise, experience and understanding and is done in accordance with HM Revenue & Customs (HMRC) regulations.

### **Acceptable Property**

Direct investment in property or land must be of a commercial nature. Investment directly in residential property is not allowed. Investment in residential property must be via a "genuinely diverse commercial vehicle" – basically no one investor (or connected party) can own more than 10%. See our leaflet on Residential Property for more details on what is classed as Residential Property and for information on the structures required to invest in residential property.

**Development land** can be considered to be commercial even if subsequently developed for residential use. The property would not be deemed to be residential until a certificate of habitation is issued. Extra care must be taken if the Scheme were to make regular purchases and sales of developmental land as HMRC may construe this as trading and tax the scheme accordingly. If land is not currently in use checks need to be made as to its history. If it was last used for one of the residential purposes set out above then it is still treated as residential property.

**Agricultural land** is classed as commercial property but must be used strictly for agricultural purposes. Similarly forestry must also be commercial. You are not allowed to derive 'indirect benefits' from

such investments, eg the usage of sporting facilities (shooting, fishing etc) or the benefit of land adjoining your private residence.

**Hotels and residential care nursing homes** are allowable as are Guest Houses and Pubs but special care must be taken. You must not reside on the premises as this would be classed as an 'indirect benefit'. The business must be separate from the building as the Scheme cannot 'trade'. Similarly, children's care homes, student halls of residence (but not flats) and even prisons are classed as commercial.

### **Residential element of commercial property**

The inclusion in a commercial property of

- a caretaker's flat;
- a residential part of a property occupied by an employee as part of their employment;

would not preclude the property being held as a scheme investment. Any such residential accommodation must be an integral or associated part of the commercial property.

### **Other factors to consider**

Properties with a history or potential for contamination problems are unlikely to be a suitable investment. An environmental report is required prior to purchase.

The property may be either freehold or leasehold. But if it is the latter there must be still a considerable number of years on the lease.

Property may be bought jointly with one or more other parties, including other SIPPs, but we require a syndicate agreement to be put in place.

Care must be taken if transacting with a 'connected party' as this must be a commercial transaction at 'arms length'.

**The legal bit**

Experience has taught us that a commercial property transaction through a pension fund can be complex and best handled by solicitors fully conversant with the procedures involved. You are free to decide which solicitor will handle the work. However you should ensure your chosen lawyer is experienced in commercial property transactions. Alternatively we have arrangements with a number of firms whom we are confident have the necessary expertise to handle this type of transaction and who understand the legal and administrative framework of the MW SIPP. Please ask us for details.

The solicitor’s duties include:

- a) Arranging the conveyance of the property;
- b) Drafting the lease or reviewing an existing lease;
- c) Agreeing the facility letter, the form of legal charge and terms and conditions with the lender if you require a mortgage
- d) Syndicate agreement if you are joining with others to buy a property.

The legal owners of property in the MW SIPP will be MW SIPP Trustees Ltd. Consequently MW SIPP Trustees Ltd will instruct the solicitor on behalf of the SIPP. As for any form of investment transaction, this will be undertaken on the basis that the trustee’s liability is restricted to what can be secured from the net realisable assets of your SIPP.

The legal fees, Stamp Duty and expenses can be paid by your pension fund.

If the property purchase is abandoned at any time you must be aware that any legal fees and expenses incurred to date are due and payable.

**VAT**

Where an ‘option to tax’ is in place on a property, subject to the correct procedures, MW SIPP Trustees Ltd will reclaim the VAT payable on the purchase price of the property. Following the repayment of VAT by HMRC the VAT element will be credited to your SIPP funds. The reclaim can take about three months to complete and you must ensure there are sufficient funds in the SIPP to pay the VAT in the first place.

Subsequently VAT will be charged on the rent due on the property and on any future sale of the property. We shall arrange for the completion of the VAT returns each quarter.

**Stamp Duty Land Tax (SDLT)**

All commercial property transactions where the consideration paid (purchase price plus VAT) exceeds the non-residential threshold rate of £150,000 is subject to SDLT.

The rates on purchases are as follows:

Consideration	SDLT Rate
£0 - £150,000	Zero
Over £150,000 - £250,000	1%
Over £250,000 - £500,000	3%
Over £500,000	4%

Stamp duty is also payable on the net present value (NPV) of the rent on new leases that run for more than five years. If NPV is more than the non-residential SDLT threshold, the buyer has to pay SDLT on the rent as well as on the premium. You calculate the tax at a flat rate of 1% on the amount of the net present value over the threshold. This would normally be paid by the tenant in the property.

Sufficient funds must be available to cover the payment of the SDLT.

**Before commencing a purchase you must ensure there are sufficient assets in the SIPP to cover all taxes eg Stamp Duty, VAT and fees.**

### **Financing the purchase**

In addition to the purchase price of the property the following costs may be incurred:

- Legal fees, land registry fees, search fees
- Surveyors fees
- MW SIPP property facility fees
- Insurance
- VAT
- SDLT
- Legal fees for arrangement or review of lease
- Property management
- Lender's legal fees including any mortgage facility fees and security fees.

The SIPP funds must be sufficient to cover at least 2/3 of the purchase price plus costs.

In addition to any personal contributions made, these funds can comprise transfers from other registered pension schemes or contributions from your employer. Contributions are not related to earnings but tax relief on personal contributions is limited to 100% of net relevant earnings. Contributions by your employer will normally qualify for Corporation Tax relief. Total contributions by you or on your behalf to all registered pension schemes of which you are a member are limited, for tax relief purposes, to the Annual Allowance. Transfers can take several months to complete.

The anticipated rental income for the property must be sufficient to meet the loan repayments (which must be on a commercial basis) plus any other expenses, plus any margin required by the bank loaning the mortgage. You should also bear in mind that interest rates may subsequently rise.

### **Mortgage arrangements**

MW SIPP Trustees Ltd as the trustee of the MW SIPP is able to borrow money to purchase a property where your funds are insufficient to purchase the property and pay the expenses outright. The loan will be on a normal commercial basis from a commercial lender. Whilst it is the member's responsibility to find a lender and agree

terms, we have contacts with a number of lenders and can make arrangements for you to meet suitable lenders. All lenders must be made aware that they are lending to MW SIPP Trustees Ltd as the trustee and not to you. It is very important that your nominated lender establishes the scope of the facility and the terms with MW SIPP Trustees Ltd who will then issue standard instructions and liaise with them regarding the requirements to reach a final decision.

The amount the SIPP can borrow is limited to 50% of the net value of the SIPP fund less any existing borrowing.

### **Example**

SIPP has assets worth £200,000 but has a liability in the form of existing borrowing of £50,000. The maximum amount which can be borrowed is £200,000 less £50,000 x 50% = £75,000. The outstanding existing borrowing is £50,000 so further borrowing is limited to £25,000.

### **Insurance**

All property owned within the MW SIPP must be insured. There should be buildings insurance, including property owner's liability cover. The insurance should also provide for three years loss of rent, terrorism cover and, where applicable, environmental cover. The cost of insurance will be paid out of your SIPP funds but is usually recoverable from the tenant(s) of the property in accordance with the lease. There are certain minimum levels of insurance that we require be put in place.

The insurance must be effective from the date of completion. We will provide you with a quote from our insurance brokers.

In the absence of evidence that equivalent insurance has been arranged we will put the property on cover from the date of completion. Certain lending institutions may insist on their own insurance arrangements.

Where an existing lease is acquired particular attention must be given to the insurance aspects including suitability of cover and the responsibility for payment of premiums.

### **Valuation reports**

No purchase can be completed without a surveyor's report which should be no more than 6 months old. MW SIPP Trustees Ltd will instruct your nominated surveyor who must be RICS qualified.

Where the purchase is being financed with the assistance of a mortgage the lender may require the valuations to be carried out by their nominated valuer.

The report must be addressed to MW SIPP Trustees Ltd as trustee of the MW SIPP.

The report should include:

- an open market capital valuation
- an open market rental valuation
- an insurance reinstatement valuation
- an environmental report

The surveyor should also make any necessary recommendations as to whether a structural survey and an asbestos report are required.

The cost of the survey and any subsequent reports can be paid from your SIPP funds. If the purchase takes some time to complete it may be necessary to repeat the survey.

### **The Lease**

The solicitor acting for the property purchase will also need to deal with the lease to the tenant(s) in the property. The standard lease is fully repairing and insuring which means that the tenant(s) will be responsible for the upkeep and maintenance of the property, and for paying the insurance premiums vi insurance rent (the insurance cover will have been arranged by the trustee). The tenant will also be responsible for paying any stamp duty on the lease.

It should be noted that the lease should have a term at least equal to that of any mortgage.

### **Property Management**

#### ***Day to day management***

It is the Trustees responsibility to ensure that the property is correctly managed. Where a property is tenanted by the member's business, the property will normally be managed directly by the Trustee. The member liaising with MW SIPP Trustees Ltd as necessary. Where there is a single occupier the Trustee will act as the property manager or appoint an independent profession property manager.

Where members joined together in a syndicate to purchase a property which is let to a single occupant they must either appoint an independent property manager (acceptable to MW SIPP Trustees Ltd) and an appropriate management agreement should be completed. Alternatively the Trustee will manage the property and they should elect one of their number to act as the liaison with the Trustee.

In the case of multi-let properties proactive property management will be required and MW SIPP Trustees Ltd will appoint an independent property manager in consultation with the members.

#### ***Rent invoices***

We expect all rent payments to be made by standing order and to be in the Scheme bank account but the due date. Rental invoices will be issued on behalf of MW SIPP Trustees Ltd.

#### ***Rent Reviews***

Rent reviews should take place at regular intervals, normally between 3 and 5 years. This will be detailed in the lease. The review should determine the market rent, be independent and carried out by a surveyor; their fees are payable from the SIPP funds.

#### ***Repairs and Other Additional Work***

Under the terms of the lease minor repairs are the responsibility of the tenant. If more extensive work is required, which will increase the value of the property, the responsibility rests with the landlord ie MW SIPP Trustees Ltd and the cost will be funded from either the member's funds or by way of a loan. The Trustee must be consulted prior to the commencement of any work.

### **Joint Property Purchases**

If a number of members with MW SIPP's wish to use their pension funds to collectively purchase a property then this can be achieved by the individual SIPP's joining together to purchase the property. A legal syndicate agreement must be put in place, prepared by our solicitors.

Each SIPP will have its own bank account but we may also establish a property administration bank account when it is a syndicated purchase.

The property will be owned by MW SIPP Trustees Ltd and the percentage interest each member has in the property will be specified when the property is purchased. This will be determined by the contribution each member's MW SIPP makes to the property purchase. Subject to certain HMRC restrictions the percentage allocation of the property can be altered in the future, subject to the property being valued by a chartered surveyor, all members agreeing in writing to the reallocation and there being a transfer of cash or assets between the individual SIPP funds to the appropriate value. This may be useful if a member involved in the property purchase wishes to retire, or if a new member wishes to participate in the property. The mechanism for this should be all contained in syndicate agreement.

The members could nominate one of their number as a property manager to carry out the day to day administration of the property. However we strongly recommend that consideration be given to appointing a professional; firm of property managers.

The surplus proceeds (rental income less mortgage costs and expenses) held in the property bank account will be distributed to individual SIPP accounts on a regular basis in accordance with the percentage holding of each member. In extreme circumstances funds may have to be transferred from the individual account to the property account to meet any need for additional finance in relation to the property. This again will be done in relation to the percentage holding of each member.

If borrowing is required then MW SIPP Trustees Ltd will enter into the loan agreement with the lender on behalf of all members of the syndicate. In all cases the liability of MW SIPP Trustees Ltd will be limited to the value of the SIPP and personal guarantees are not allowed to secure any loans made to a SIPP.

If any member is likely to commence benefits with in the next ten years, or has already, then special considerations will apply.

Joint purchase can be made with parties other than other members of MW SIPP but this will incur extra costs and these transactions have added complications. In these cases a strong syndicate agreement must be in place prior to purchase and a professional property manager must be appointed.

### **Sale of the Property**

When the decision is made to dispose of the property a suitable qualified independent agent must be appointed to advise on the best way to market the property and the selling price. If the property is to be sold to a connected party a valuation must be obtained from a suitable qualified valuer to confirm that the sale price represents the true market value of the property.

**If you feel that the intended property purchase fits the criteria set out in this guide the next step is to complete the Property Purchase Application Form and**

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