# Investing in Prime Commercial Property Through Syndication

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CHARTERED SURVEYORS

Druces LLP

SOLICITORS

## Introduction

Reid Rose Gregory, working with Druces LLP solicitors, have been working together since 2008 to offer private investors the opportunity for investment in UK commercial property through tax efficient property syndication. This opportunity is open to sophisticated and high net worth investors.

RRG is currently celebrating its 33rd year, and is able to draw on a wealth of market experience and advises on all aspects of commercial property. It is a niche practice specialising in the investment and retail sectors, and offers national coverage with offices in Mayfair, London and Manchester. RRG has a proven track record, and adopts an entrepreneurial approach to property solutions, partner involvement at every level as well as complete independence and impartiality.

The Investment department comprises Simon Gregory, Bill Stephens and David Whirledge who act for a wide variety of institutions, property companies and private clients.

To find out more about the services they offer, please go to their website at www.rrg.co.uk

Druces LLP is a well-established City of London firm. It is a full service practice with a particular expertise in property investment through syndication and co ownership. The Property Department is at the heart of the firm but draws on service groups within the other departments including tax, financial services, company / commercial and litigation. Clients range from pension funds to private investors and retailers.

The Property Syndicate team at Druces LLP comprises Karen Chapman, Nick Brent and Suzanne Middleton Lindsley.

Further details about Druces LLP can be found on the website at www.druces.com

## The UK Property Market

The UK property market continues to offer good returns to investors where compared to other asset classes.

The recent Brexit vote temporarily affected the market, but there is no doubt that the market has bounced back strongly and investors are consistently seeking income returns, with a huge amount of equity available across all property sectors.

With the all property average yield at around 6.5% and base rates having fallen further to 0.25%, property still looks an attractive proposition in comparison to other types of investments.

The stock market has been volatile, deposit accounts offer only 0-2% often with the money tied up for guaranteed periods, gilts at between 1-2%, and some Government Bonds at negative rates, with none offering prospects of capital growth.

So why invest in property?

- Disaffection with returns from other asset classes such as shares, unit trusts, deposit accounts, gilts etc
- Lack of trust in the financial markets and financial advisors
- Direct property interest acquired, therefore a 'tangible' asset
- Property can offer a secure income return and the prospect of capital growth
- Financing purchases enables income returns to be enhanced
- Low interest rates means the possibility of cheap finance opportunities

## Investment Criteria

Given current market conditions it is anticipated that investments will seek income opportunities targeting annual returns of between 7 -10%, excluding capital growth.

We will target properties of between £500,000 - £2,000,000, and it is anticipated that opportunities will largely satisfy the following criteria:

- Prime location
- Quality 'bankable' covenants, offering sustainable security of income
- Well configured buildings capable of a long economic life
- Minimum lease length of 8 years

We will particularly target prime retail units, retail warehouses and well located modern warehouse/industrial units.

We are now seeking properties in prime locations with shorter leases where higher returns are available, but where we are confident of retaining tenants or re-lettiing quickly.

Buildings offering greater capital growth and asset management opportunities will be targeted, as will larger lot sizes.

All purchases will be open ended, but with a likely lifespan of between 2 – 5 years, although ultimately the participating syndicate investors have the ability to determine the point of sale.

RRG will prepare a strategy paper for interested investors for each property when an opportunity becomes available.

## Why Syndication

The private investor has traditionally been unable or unwilling to invest directly into commercial property, either because funds were insufficient or, if sufficient, might expose him to undue risk by putting all his money in one property.

Syndication allows groups of people to join their resources, and, with relatively small amounts of money, enables them to buy property which would otherwise be out of their reach.

## The Vehicle

Druces LLP has been working with clients for many years to develop an ownership structure for syndication which provides protection for investors and security for lenders where non recourse finance is required or desired to leverage investments.

Druces LLP has developed the Trust Based Structure and has, to date, completed in excess of 300 syndicates using this structure.

Participating investors, or syndicate members as they are otherwise called, can be private individuals, companies, overseas investors, offshore funds, charities or pension schemes. A large number of syndications have been undertaken especially for SSAS and SIPP investors for whom these have proved a secure and ideal investment vehicle. Any one syndicate can contain any combination of “investor types”.

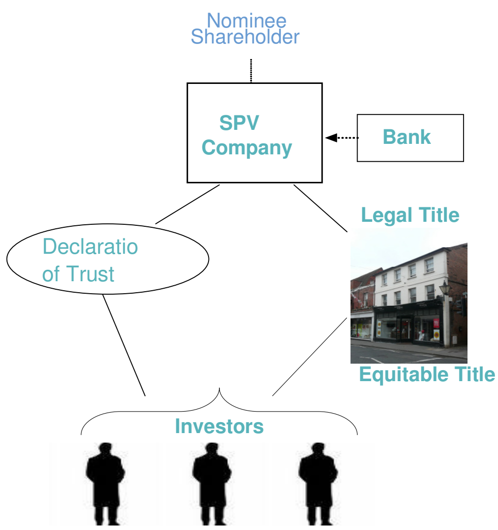
## Legal Structure

Properties are acquired through newly established nominee companies, formed by Druces LLP.

Each new special purpose vehicle enters into a Declaration of Trust with the syndicate members to declare that it holds the property as legal owner on trust for those members, each of whom owns a defined share of the property. After the sale of the property within a syndicate, it is dissolved and struck off at Companies House to ensure that no residual liabilities arise thereafter.

The companies have no inherent value – they are non-trading nominees. They have an issued share capital of £1 and this share is held by D&A Nominees Limited, Druces LLP’s in house nominee shareholder. No shares are allocated to syndicate members and the companies file dormant company accounts each year.

Trust for Sale



## Financial Services and Markets Act 2000 (FSMA)

Property investment schemes are dominated by statute and regulation. Generally speaking, if a group of people collectively invest in the purchase of a property which has been sourced and will be managed by an agent or manager, the arrangement **could** be considered to be a Collective Investment Scheme. A Collective Investment Scheme **must** be managed by an FCA authorised person.

Most property agents seek to steer clear of regulation not only because of the administrative burden, but also because of the costs involved. However, with regulation comes protection for investors.

A number of statutory exemptions exist which take arrangements which would otherwise be Collective Investment Schemes out of the definition i.e. they are exempt.

Arrangements where syndicate members have **day-to-day control** over all the arrangements affecting the property and where professional advisors have no independent discretion, are exempt.

The Trust Based Structure has been developed so that, provided certain procedures are put in place and then properly followed, the arrangement should be exempt and should not constitute a Collective Investment Scheme. It follows that it does not need to be regulated and does not have to be managed by an authorised person.

The Trust Deed, therefore, regulates how each property is held and managed. For example, it requires the nominee companies to ensure that the property agents obtain the consent of or instructions from all of the syndicate members before taking any action in relation to the property. The director and secretary of the nominee companies take no part in the day-to-day running of the property, or in the decisions that have to be made by the syndicate members.

Because of the requirement for day-to-day control, investor numbers within any one syndicate are generally restricted to about 20, but there are exceptions.

These arrangements **must** take effect both in form and in substance and, although decisions are not usually required with any great frequency, a syndicate member must be prepared to take part in them when necessary, in co-operation with other members. Syndication is, therefore, not suitable for passive investors.

Because the Trust Based Structure is exempt, operational costs are significantly lower than many other schemes and this can, in turn, enhance returns to investors.

## Debt/Gearing

Investors will be offered the opportunity to invest in either un-geared or geared syndicates.

Financing a purchase enhances the rental and capital growth performance of the investment and can also increase the tax efficiency of the investment structure.

It is not the intention to highly leverage any purchase, but borrowing between 50 – 60% of the purchase price does significantly improve the return on the syndicate’s equity investment.

For example, if the syndicate purchases a property for £1,000,000 that yields a return on cost (the purchase price + all costs of acquisition) of approximately 7.5%, then the return on the syndicate member's equity increases in the following **approximate** proportions:


| Gearing Ratio | Return | Increase in return |
|---|---|---|
| *Ungeared* | *7.5%* | - |
| *50%* | *9.4%* | *25%* |
| *60%* | *10.3%* | *38%* |

It is anticipated that the mortgage will be provided by one of the leading lenders, and will be on a non-recourse basis, minimising any liability to the syndicate members. The interest rate may be fixed to safeguard their position and ensure that there will always be sufficient rental cover over and above any interest payment. Preferably the loans will be interest only to maintain the investors income return, but in current market conditions, the lender may require partial amortisation of the loan over the loan period. This will reduce the income return, but increase the capital return.

## Taxation

The Trust Based Structure is tax transparent. The companies, as non-trading nominees, have no tax liability and each syndicate member is taxed on their share of the income and any gain in accordance with their own personal circumstances.

Pension Schemes can enjoy both income and capital gains tax free. For private investors the structure is also very effective; for example, a share can be taken jointly by a husband and wife who can use both Capital Gains Exemption Allowances (if available to each of them) to reduce their liability to CGT.

Overseas or off-shore investors may be able to claim further reliefs.

If the syndicate members do not exercise day to day control the arrangement could be deemed an unregulated Collective Investment Scheme, and be taxed accordingly.

Stamp Duty Land Tax is, of course, payable on the property purchase at the appropriate rate.

## Money Laundering Regulations

When making a decision to proceed with the purchase of a share in a property, syndicate members must ensure that they have cash funds available to place with Druces LLP at short notice. It is anticipated that each syndicate will be required to act quickly to secure appropriate investment opportunities.

Initial syndicate subscriptions will be paid into Druces LLP's client account to enable the property to be purchased. An exchange of contracts for the Property can only take place once **all** subscriptions are paid by syndicate members. In order to accept funds, potential syndicate members will need to provide Druces LLP with two certified copies of both their passport and a recent utility bill, or other compliant ID.

Trustees and companies must provide equivalent identification.

## Liquidity and Promotion

There are strict rules on advertising and promoting interests in Collective Investment Schemes. As the Trust Based Structure is not such a Scheme arguably these rules do not apply. However, interests in syndicates are not **publicly** advertised or promoted. There are no restrictions on the sale of syndicate interests, but there is no natural external market. Syndicate members should, therefore, be prepared to participate for the period of time set out by the RRG strategy paper for each property. Generally, property is seen as a relatively illiquid asset and it may take some months before an investor receives his capital back at the end of the investment period.

Should an investor wish to realise his investment prior to the maturity of the investment strategy for the property, the share will be offered at the required price to other syndicate members in the first instance, and thereafter if necessary to investors outside that particular syndicate. In some circumstances interests may be traded among the members of a particular syndicate, and an active trading market may develop within these ventures. Any transfers can usually be completed fairly quickly – within two weeks – thus offering a liquidity which is comparable to the equity market, and far quicker than is normally possible in the direct property investment market.

Syndicate members should also be aware that, although financial information for each syndicate is not in the public domain, the details of each member and the amount contributed will be available to each and every member within a given syndicate.

Because syndicates have a substantial minimum investment and interests are not readily realisable they are only suitable for sophisticated investors or high net worth individuals. Persons registering to express an interest in particular property opportunities will, therefore, be asked to certify that they are sophisticated or high net worth, as if they were entitled to receive an exempted financial promotion under the Financial Services & Markets Act 2000.

## RRG – Role and Charges

**RRG** will identify suitable investment opportunities and prepare a strategy paper for each proposed purchase outlining the property's likely return and future performance.

For each acquisition **RRG** will be paid the standard introductory fee of 1.5% of the purchase price.

For each disposal **RRG** will be paid the standard sale fee of 1.5% of the sale price.

An annual management charge will be made based on 5% of the gross rents collected, which will include any loan administration and VAT returns, if applicable.

**RRG** will deal with any asset management opportunities that arise such as:

- Lease re-gears
- Re-lettings
- Rent reviews
- Lease renewals


Fees in relation to such matters will be dealt with on an ad hoc basis, with fees being agreed with the syndicate members at the appropriate time. As a general guide re-gears and re-lettings will be based on 10% of any annual headline new rent negotiated, and reviews/renewals at between 5-8% of the rent agreed, depending on level of rent and increase.

Fees are quoted exclusive of VAT.

## DRUCES LLP – Role and Charges

**Druces LLP** will act as legal advisors for the syndicate members in the purchase and sale of a property within a syndicate, including the carrying out of all necessary due diligence and reporting to syndicate members. They will liaise with the syndicate's accountants to procure VAT registration where necessary and also with lender's solicitors where non-recourse finance is being obtained.

**Druces LLP**'s fees for acting on a purchase will be 0.95% of the purchase price on acquisitions, and on a sale will be 0.5% of the sale price.

There may be an additional charge to an individual investor if investing through a SIPP and Druces have to engage in correspondence with the SIPP provider.

Estate management will be carried out at **Druces LLP**'s standard charge out rates, and will be discussed on a matter by matter basis with **RRG**, and approved by syndicate members, in advance.

Thereafter, there will be an annual administration fee of £500 per company for dealing with the annual returns and dormant company accounts and liaising with the accountants to produce year end certificates for syndicate members.

Fees are quoted exclusive of VAT and disbursements.

## Gearing

Where mortgages are arranged to fund a purchase there is likely to be an arrangement fee charged by the lender which will be agreed with them on the most commercial basis at the appropriate time. Where this has been arranged by **RRG**, an additional 0.25% of the loan as an administrative charge will be payable

There will be additional legal fees in dealing with the mortgagee and their requirements including the mortgage documentation. This will be charged at 0.25% of the loan.

In some circumstances, properties may be re-financed during the period of ownership to either improve terms or to release capital. **RRG** may charge a fee for the administration process, which will be agreed with the syndicate members at the appropriate time. There will be legal fees associated with this process and again **Druces**' fees will be agreed with the syndicate members at the time.

## Accountants – Role and Charges

The syndicate's accountants will provide annual accounts at each year end and act as registered office for a fee of approx £1,000. Each individual syndicate investor will receive a certificate in relation to the distribution on their holding which can be forwarded to the Inland Revenue for return purposes.

The accountants will procure the syndicate's VAT registration, if appropriate, for £600 and thereafter deal with the syndicate's VAT return for a fee of £480 a year.

The accountants will provide the syndicate's annual return for a fixed fee of £200 and dormant company accounts for each nominee for a fixed fee of £210.

These fees are charged directly to each syndicate by the Accountants.

Fees are quoted exclusive of VAT.

## Next Steps

If you are interested in the idea of investing in prime commercial property through syndication, please contact Simon Gregory or Bill Stephens at RRG.

We will need the appropriate certificate from you in one of the forms with this memorandum and found behind the last page. You can either complete the relevant one appropriate to you now and send it to RRG or they can send you the appropriate form after you have spoken to them.

**SIMON GREGORY**
Direct Dial: 020 7518 1528
Email: sgregory@rrg.co.uk

**BILL STEPHENS**
Direct Dial: 020 7518 1527
Email: bstephens@rrg.co.uk

If you would like more information on the Trust Based Structure, then please contact Suzanne Middleton Lindsley or Karen Chapman at Druces LLP.

**SUZANNE MIDDLETON LINDSLEY**
Direct Dial: 020 7216 5555
Email: esml@druces.com

**KAREN CHAPMAN**
Direct Dial: 020 7216 5591
Email: k.chapman@druces.com

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## Statement for Certified High Net Worth Individual

I declare that I am a certified high net worth individual for the purposes of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005.

I understand that this means:

(a) I can receive financial promotions that may not have been approved by a person authorised by the Financial Services Authority;

(b) the content of such financial promotions may not conform to rules issued by the Financial Services Authority;

**(c) by signing this statement I may lose significant rights;**

(d) I may have no right to complain to either of the following—

(i) the Financial Services Authority; or

(ii) the Financial Ombudsman Scheme;

(e) I may have no right to seek compensation from the Financial Services Compensation Scheme.

I am a certified high net worth individual because **at least one of the following applies—**

(a) I had, during the financial year immediately preceding the date below, an annual income to the value of £100,000 or more;

(b) I held, throughout the financial year immediately preceding the date below, net assets to the value of £250,000 or more. Net assets for these purposes do not include—

(i) the property which is my primary residence or any loan secured on that residence;

(ii) any rights of mine under a qualifying contract of insurance within the meaning of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001; or

(iii) any benefits (in the form of pensions or otherwise) which are payable on the termination of my service or on my death or retirement and to which I am (or my dependants are), or may be, entitled.

**I accept that I can lose my property and other assets from making investment decisions based on financial promotions.**

I am aware that it is open to me to seek advice from someone who specialises in advising on investments.

……………………………….
Signature

……………………………….
Date

## <u>Statement for Self-certified Sophisticated Investor</u>

I declare that I am a self-certified sophisticated investor for the purposes of the Financial Services and Markets Act (Financial Promotion) Order 2005.

I understand that this means:

(a) I can receive financial promotions that may not have been approved by a person authorised by the Financial Services Authority;

(b) the content of such financial promotions may not conform to rules issued by the Financial Services Authority;

**(c) by signing this statement I may lose significant rights;**

(d) I may have no right to complain to either of the following—

(i) the Financial Services Authority; or

(ii) the Financial Ombudsman Scheme;

(e) I may have no right to seek compensation from the Financial Services Compensation Scheme.

I am a self-certified sophisticated investor because **at least one of the following applies—**

(a) I am a member of a network or syndicate of business angels and have been so for at least the last six months prior to the date below;

(b) I have made more than one investment in an unlisted company in the two years prior to the date below;

(c) I am working, or have worked in the two years prior to the date below, in a professional capacity in the private equity sector, or in the provision of finance for small and medium enterprises;

(d) I am currently, or have been in the two years prior to the date below, a director of a company with an annual turnover of at least £l million.

I accept that I can lose my property and other assets from making investment decisions based on financial promotions.

I am aware that it is open to me to seek advice from someone who specialises in advising on investments.

……………………………
Signature

……………………………
Date