



1. Introduction

BCSC welcome the opportunity to comment on the government's draft legislation 'UK Real Estate Investment Trusts (UK-REITs)'. BCSC are a membership organisation representing all those involved in the retail property industry including developers, owners and occupiers. As such, we believe we are well placed to comment on the impact and implementation of the legislation. Detailed below are the following eight specific areas of commentary:

- Interest rate cover – Gearing
- The sale of assets
- Development
- Refurbishment and Extension v Development
- Schedule 'A' Income
- Transparency vehicles
- Restriction on Ownership
- Breach of REIT rules

BCSC support the introduction of REITs and hope that our comments prove useful in fine-tuning the enabling legislation.

2. Interest rate cover - Gearing

Within the retail sector a large number of specialist funds have been created which allow institutional investors to invest in specialist asset management skills. One of the common aspects of these funds is their ability to gear at moderate levels, as the investor base tends to be more institutional than private. The industry norm for gearing in these funds is between 50 – 60%. For example, The Grosvenor Shopping Centre Fund (60%), the L&G Leisure Fund (60%) and the LOG Performance Retail Fund (75%).

We have two concerns over the interest rate cover arrangements proposed in the legislation.

1. We are concerned that the interest rate cover proposed is insufficient and would not allow prudent gearing of up to 60%. As a consequence, we are concerned that specialist funds would not convert to REIT status as this would require them to sell assets in order to bring their debt levels down. The same would be true of some of the large property companies.
2. Low gearing would prevent funds from undertaking refurbishment improvements to a shopping centre. This point has been raised by a number of funds including one run by Lend Lease.

The industry understands and recognises gearing ratios and we would prefer this to be adopted as well as interest rate cover.

3. The Sale of Assets

The nature of specialist vehicles targeting specific sectors is their ability to trade assets. The government recognises that the ability to reinvest monies from the sale of assets cannot be immediate, but it is proposing that income

from cash is taxed. We consider this will be a strong disincentive to active asset management through the sale of under performing assets as the ability to immediately reinvest is extremely difficult. We would therefore propose that income earned on cash following the disposal of an asset remains untaxed for a period of 12 months. If the cash has not been invested at the end of that period it then becomes a taxable item.

4. Development

In relation to the treatment of properties being developed, we propose that companies be permitted to elect when, in their opinion, a development has reached the stage when it has become an investment and can be inserted into the REIT. This is because a development, say a Shopping centre, can become 'an investment' at differing stages. For example:

- Upon hitting 75% plus pre-lets
- Upon practical completion
- Upon becoming substantially income producing

The stage at which a development becomes an investment will vary dependant upon the strength of the market. Therefore, it is appropriate that all companies are allowed to take the decision of when to transfer to investment status at market value with an appropriate external valuation taking place.

5. Refurbishment and Extension vs. Development

The shopping centre and retail warehouse sector is significantly different to other sectors in terms of their requirements for continued refurbishment / extension in order to maintain their vitality and viability. This activity is part of the normal course of improving performance of the asset for customers, occupiers and investors alike. We are concerned that under the proposed legislation a grey area emerges as to whether or not a refurbishment, partial extension or expansion of a centre takes the existing centre out of a REIT status into a development (and thus taxed) category.

From the retail sectors perspective, we consider it imperative that any refurbishment or extension of an existing centre is capable of being left within the REIT. Consequently for the purpose of the legislation "Development" should not include any refurbishments or further extensions where the majority of the existing tenants remain in situ. A significant number of shopping centres within the industry are continually refurbished and extended recent examples include:-

- The Plaza, Oxford Street
- Marineaux Place, Birmingham
- St Enochs Shopping Centre, Glasgow

In relation to 'pure' redevelopment, we consider that this does fall outside the remit of a refurbishment and extension. The difference being that the existing



asset has reached the end of its economic life. Recent examples of this would include: -

- The Bull Ring, Birmingham
- Tricorn Shopping Centre, Portsmouth

In both cases vacant possession was obtained before total demolition.

We would be happy to provide a more detailed example of the differences between refurbishments and redevelopments.

6. Schedule A Income

We would like clarification over the specific inclusions of income for the purpose of the retail sector. Integral to the running and functioning of retail centres is the income derived from activities such as: -

- Car Park
- Mall activities
- Advertising
- Promotional activities
- Entertainment

This income should be included in schedule A. We do not consider that HM Revenue will suffer as this income is capitalised along with all other income in the valuation of assets and will therefore be captured in the conversion charge.

7. Transparency Vehicles

We reiterate our previous recommendations for the need for full transparency through the listed vehicle to investors, setting out business plan, remuneration of directors and fee levels charged to investors. The nature of the minimum life of a REIT, coupled with the limitation on ownership, does give existing management added protection to that currently existing and thus transparency upgrades are important.

8. Restriction on Ownership

We are concerned that the restriction on ownership at 10% will discourage property companies and specialist vehicles from converting to REIT status. This has been picked up by a number of other organisations and we would want a percentage high enough to encourage that conversion. We would be comfortable with ownership restrictions between 20-25%.

9. Breach of REIT rules

It is possible that situations will arise where REIT rules are unintentionally broken. For example, interest rates could increase and in such a situation the breach could be long-term. The REIT cannot de-list (due to the financial implications of the 10 year rule) and thus becomes tax inefficient. One choice open to the REIT would be to sell some assets, however in doing so the income on the cash would be taxed until reinvestment. Some further



consideration of the implications of procedure when rules are breached is needed.