



Exploring Pensions is designed and written for practising chartered accountants, with its focus on pension issues of greatest interest to the owner-managers of privately owned businesses.

The authors, Mattioli Woods, specialise in this area of pensions consultancy, providing a trouble-shooting service for clients and advisers throughout the UK.

Exploring Pensions

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Property purchase in the pre-2006 world

With the countdown now well underway, to pension changes due in April 2006 it is increasingly imperative that clients are made aware of how the changes will impact on them.

One key area of concern is the technical changes to the ability of both small self-administered schemes (SSASs) and self-invested personal pension (SIPPs) to purchase property.

Whilst financial press headlines have highlighted the fact that residential property will now be a potential investment previously forbidden (along with purchasing property in retirement), the alterations to the amount the fund can borrow is a key factor that could well result in clients being unable to acquire a property post-April 2006 that they could have acquired pre-April 2006.

Whilst any form of direct property purchase cannot be made on a short-term whim (ultimately an appropriate

property needs to be found!), at the same time it is important that the pension scheme provider is able to ensure the purchase can proceed in both a proactive and professional manner. As an organisation, we are finding ourselves spending an increasing amount of time either rescuing problematic property purchases or taking over schemes whereby property-based schemes have been poorly administered. As this issue of Exploring Pensions will hopefully highlight, Mattioli Woods has both the expertise and experience to be able to deal with both 'vanilla' property purchases along with purchases that need a little bit more love and attention.

At the same time, the newsletter also explores the whole concept of investing in property, which we believe continues to represent a sound investment opportunity for smaller type pension funds, such as SSASs and SIPPs.

Mattioli Woods
Pension Consultants



Property – a core investment for small pension funds

Property, typically prime commercial property, has long been regarded as an eminently suitable asset class to diversify investment portfolios. However, large pension funds in particular have been reluctant to build in anything other than small percentages as a consequence of over-reliance on equity markets and concern about illiquidity. However, smaller pension funds can afford to take a much more aggressive stance.

With the residential property market now past its 'sell by date', it is tempting to perceive commercial property as an investment which is now 'fully priced'. However, there may be good reasons why prime commercial property should continue to be treated as a core asset class for smaller pension funds.

Firstly, despite the recent boom in 'buy to let', commercial property offers a number of advantages over residential, including higher rental yields (on average); lower property expenses; and (usually) greater tenant responsibility.

Commercial property, like its residential counterpart, has seen strong price rises in recent years, and unusually so with a weak economy and a near total absence of upward rent reviews. The reason why commercial property has performed so well during such a period is simply that,

having been a neglected asset class for many years, rental yields by the late nineties looked exceptionally good value relative to declining interest rates and a bear market in equities.

It is probable that that seam of growth is now over. Nonetheless, there remain real attractions to prime property in particular. Rental yields on a balanced portfolio are still close to 6%, making prime property the highest income-bearing investment; after a year of strong economic growth, and a continued positive prognosis for the economy, some rent increases may now manifest, and taking a medium to longer-term view, assuming the economic growth is sustainable, this should lead to price growth as well.

In short, and relative to the other main asset classes, property offers the prospect of (relatively) high returns from an asset which historically has enjoyed low volatility.

Large pension funds and other investment institutions will only ever hold relatively small percentages of commercial property because of the concern over realisation and illiquidity. However, a private pension fund can afford to be much less concerned, given its ability to disinvest with much greater ease.



Mattioli Woods comes to the rescue

Two clients ran a successful motor dealership in the South West of England, and due to the success of the business were looking at acquiring a larger commercial property from which to further expand the business. After around six months of searching, an ideal site was located near their existing premises, which would allow the business to continue its growth, but at the same time maintain its existing client base.

Whilst the company had sufficient liquidity to purchase the property itself, their accountant made the clients aware of the ability to purchase the commercial property within a pension scheme, using the immediate company profits to pay a contribution into such a scheme which, with bank borrowings, could then purchase the property, whilst at the same time reducing the company's corporation tax liability.

At the same time, the clients were advised by a financial adviser to utilise the services of a large well-known SIPP provider. However, it became apparent as the transaction progressed that whilst the SIPP provider's fees were cheaper than Mattioli Woods, the SIPP provider simply 'provided the scheme' and gave no additional consultancy support, proactive administration, advice or flexibility.

As the purchase progressed, the clients became increasingly concerned over caveats placed by the SIPP provider requiring geological contamination tests on the ground, and additional environmental studies along with the property and rental valuations. Despite a reasonably proactive bank, ongoing requests for these reports and slow administration eventually persuaded the vendor to pull out of the deal. As a result, in order to avoid losing the site, the clients had to simply purchase the property through the limited company.

At this point, Mattioli Woods became involved in order to investigate whether the property within the company could now be transferred to a pension scheme. On reviewing the full situation, due to the valuation of the property and level of borrowings required, the SIPP was by far the better vehicle, as it was able to borrow more funds than the SSAS. However, as the property was now owned by the company, the property could not be transferred into a SIPP, due to the connected nature of the transaction, and therefore the previous provider had, in effect, closed the SIPP route for the clients.

However, the clients still wanted to investigate the transfer of the property into a pension scheme, and as a result a SSAS was established with the transfer of existing benefits into it. An actuarial review was undertaken, with variations of salary used in order to get to a position whereby, based on a realistic level of salary, a contribution level could be obtained that would then allow the pension scheme to buy the premises from the company (with bank borrowings). In turn, by arranging for bank borrowings to be approved prior to purchase, it was possible to make a sizeable contribution and on the same day buy the property from the company, ensuring the company's cash flow was not detrimentally affected.

Whilst Mattioli Woods' costs were higher than the large SIPP provider, the 'value' to the client was in getting the property into his pension fund. We are now finding that an increasing number of clients want proactive administration service and consultancy advice, and appreciate that whilst this costs more than some of the schemes on offer, viewed overall, Mattioli Woods add more value and therefore justify their involvement.



The property purchase 100 metres

Mattioli Woods was introduced to a client through an established accountancy connection, who was looking at expanding his successful computer business. The client had a number of existing pension benefits in insured arrangements doing nothing and the accountant and client had come to the conclusion that these could potentially be used for a property purchase.

However, the client wanted to purchase a unit on a new industrial park, and unfortunately, due to the success of the park, units were disappearing fast. The client managed to obtain an in-principle agreement with the vendor that he would hold the last unit for him, assuming he could complete inside a month.

The first action undertaken was to review all of the client's existing pension arrangements to ensure that these could be used as the basis of a deposit for the property purchase, and at the same time ensuring that there was not a substantial penalty the client would be crystallising. At the same time, investigation with the accountant over the client's salary and maximum contribution levels was undertaken and an initial consultation was held with The Royal Bank of Scotland to ascertain their willingness to lend. The insurance companies were then harassed for the information, which they provided within seven working days, whilst a report was then forwarded to the client the same day. At the same time, Mattioli Woods spoke to the client over the phone to discuss the report with him and arrange a meeting for the following day. At that meeting the SIPP was established, contribution cheques received and encashment forms for the insurance policies were signed. Mattioli Woods then had the figures and loan requirements, so three-years' accounts were provided to

the bank with details on the loan required, which they then agreed to and arranged for a valuer to see the property immediately.

The client's solicitors (Gordons in Leeds) were advised once the scheme was established and they began negotiating with the bank and vendor regarding the purchase. Again, thanks to some proactive chasing of insurance companies, transfer cheques were received inside ten days, during which time the bank received the valuer's report, loan documentation was processed and signed by the trustees and then money released from the pension fund to the solicitor to purchase the property.

Whilst we would usually prefer a longer time period in order to complete a property transaction (!), our first contact with the client was on 2 August, with the property being purchased on 30 August.

Perhaps the one thing to learn from this transaction is that sometimes individuals are put off considering purchasing commercial property within a pension scheme on the grounds and concerns that the process takes too long. However, as highlighted by this transaction, property purchases within a pension scheme can indeed be done on a tight time-scale, assuming the scheme provider/pensioner trustee is proactive in moving the process along.

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