AUDIT • TAX • ADVISORY

Real Estate Matters

Issue 16

Construction & Real Estate Newsletter

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Now, for tomorrow

Contents

Economic update

The Chancellor of the Exchequer Rishi Sunak presented his 'Plan for Jobs' on Wednesday 8 July 2020 to outline how the government will boost job creation in the UK.

The next stage of the Government's recovery plan has begun with Boris Johnsons "Build, build, build" speech and Chancellor Rishi Sunak has now delivered his 'Plan For Jobs'. The Chancellor declared "we are entering the second phase of our economic response" before announcing £30bn worth of measures designed to protect, support and create jobs, including several targeted specifically for the construction and real estate industry.

Temporary Stamp Duty Land Tax (SDLT) cut

Effective immediately, the government has temporarily increased the Nil Rate Band of Residential SDLT, in England and Northern Ireland, from £125,000 to £500,000. This will apply until 31 March 2021 and cut the tax due for everyone who would have paid SDLT, saving purchasers up to £15,000.

Green Homes Grant

£2bn is being made available to help homes become more energy efficient and create local jobs. The government will provide at least £2 for every £1 homeowners and landlords spend to make properties more energy efficient, up to £5,000 per household. The scheme will fund those on the lowest incomes, up to £10,000 per household. The scheme aims to upgrade over 600,000 homes and could support over 100,000 green jobs.

Infrastructure improvements

The government will invest £100 million to deliver local road maintenance upgrades across England in 2020-21. This is in addition to the government's plans to spend £1.5 billion in 2020-21 on filling potholes, resurfacing roads and improving local highway infrastructure.

Job Retention Bonus (JRB)

The JRB will provide employers with a bonus of £1,000 per employee for each employee who returns to work from furlough and who is paid at least £520 per month on average between November 2020 and end January 2021.

Kickstart Scheme

The Kickstart Scheme is for 16-24 year olds who are on Universal Credit where employers create new, quality 6-month work placements. The Government will fund 100% of the National Minimum Wage for 25 hours of work per week, plus the associated employer NIC and minimum auto enrolment contributions.

Training and Apprenticeships

Additional support to triple the number of places available under the traineeship scheme, with the Government funding employers who provide trainees with work experience at a rate of £1,000 per trainee.

Green Homes Grant and VAT

In his Summer Economic Update, the Chancellor confirmed that a £2bn scheme is to be introduced in September. This would allow all homeowners and landlords in England to apply for a grant to help cover the cost of upgrading residential properties to make them more energy efficient.

The grants will cover two thirds of the cost of upgrades to a maximum of £5,000 for most properties. Low income households will be eligible to apply for a grant to cover all costs up to a maximum of £10,000. New-build domestic properties and non-domestic properties ***do not*** qualify.

While this is aimed at a longer-term ambition for a greener future, the shorter-term goal is to help create and retain jobs in the construction sector by providing an additional or increased source of income.

Details of the scheme

To qualify, homeowners or landlords need to be installing (or improving) at least one "primary" improvement which includes insulation and low carbon heating. If installing at least one of the primary improvements the vouchers can also be used to install "secondary" measures up to the same value as the primary measure. Secondary measures include draught proofing, double or triple glazing, energy efficient doors and heating controls.

The process is likely to be that homeowners and landlords can apply online and will be directed to accredited suppliers who will provide quotes. Once a quote has been approved and accepted, the government will issue a voucher to cover its share of the eligible cost. Your first action should be to ensure that you are on the list of accredited suppliers.

The impact of VAT

When it comes to quoting for work, and ultimately doing the work and billing for it, you will need to know what rate of VAT should be applied. VAT does apply at a reduced rate of 5% for the installation of certain energy saving materials, but it does not apply to all types of energy saving materials, and it does not apply in all circumstances.

For pricing purposes, and for working out your margins, you will want to know whether you'll be charging VAT at 5% or 20%, or part at 5% and part at 20%. Getting it wrong can mean the difference between making a profit and making a loss.

Reduced rate of VAT

Determining when the reduced rate of VAT applies can be a complex area to navigate, and we recommend getting advice on this to a) make sure your forecast margins are right, and b) reduce the risk of future possible assessments from HMRC if you get it wrong.

In broad terms, reduced rating applies to:

- services of installing energy-saving materials, including the energy-saving materials installed, for someone over the age of 60 or for someone who is on certain benefits where the installation is in their sole or main residence ("The social policy conditions"), or where this is not met.

- services of installing energy-saving materials in residential accommodation, including the energy-saving materials installed, unless the value of the materials exceeds 60% of the cost of the total supply made, in which case it is necessary to charge VAT at the standard rate on the materials. The labour element can still be reduced rated.

Energy-saving materials for these purposes means:

- insulation for walls, floors, ceilings, roofs or lofts or for water tanks, pipes or other plumbing fittings;
- draught stripping for windows and doors;
- central heating system controls;
- hot water system controls;
- solar panels;
- ground source heat pumps;
- micro combined heat and power units.
- air source heat pumps;
- micro combined heat and power units;
- boilers designed to be fuelled solely by wood, straw or similar materials.

Reduced rating also applies to certain grant-funded installations of heating equipment and renewable source heating systems supplied to the over 60s or those on certain benefits, but only to the extent of the grant amount.

What steps should my business take?

There will clearly be an interaction between the Green Homes Grant and the possible application of VAT at the reduced rate.

To prepare your business you should:

- Make sure you are included on the list of accredited suppliers
- Get to grips with when the reduced rate of VAT applies, so that you:
  - know what you need to ask your prospective customers to determine if the lower rate applies
  - price your quotes appropriately, maximise your margins, and allow your clients to take full advantage of the grant available, and
  - know what information you will need obtain and keep to support the VAT treatment you apply.

Contact the Indirect Tax team at MHA for more information on this key Government update.

Success with long-term contracts

If you recognise revenue you naturally recognise the associated costs.

There are four conditions:

1. Revenue to be measured reliably;
2. Economic benefits to flow to the entity;
3. The stage of completion can be measured reliably;
4. The costs incurred and the cost to complete can be measured reliably.

Accounting for amounts recoverable on contract

One of the major accounting issues for companies involved in the construction industry is the basis on which long term contracts are accounted for.

If a contract is to run 18-24 months and have a lead in of 12 months before it actually starts, the revenue has to be calculated over three to four financial accounting periods.

Many companies would like to recognise the profit at the end of the contract when the outcome is as clear as day. Unfortunately, our accounting standards do not allow this.

Accounting standard FRS102 (Financial Reporting Standard applicable in the UK and Republic of Ireland) defines the basis for the preparation of accounts – especially paragraph 23.14.

23.14 states that "when the outcome of a transaction can be estimated reliably, an entity shall recognise revenue associated with the transaction by revenue, to the stage of completion."

The first two are relatively straightforward. The last two are more likely to be conjecture; think of Spurs' new stadium or the delivery of Crossrail – Elizabeth Line. Both have had extensive delays and overrun costs. Two of the most difficult things to determine are the costs to come and the utilisation of contingencies that are built into a budget.

Contingencies are often used up for issues they were not designed to cover. This often leaves the real contingencies uncovered.

> The question is, does the FD really know the inherent risks in each and every project, independent of the PM's, so that they can take their own view on the potential outcomes?

Finance Director and Project Manager working together

The objectives of a Financial Director (FD) and a Project Manager (PM) should be aligned because they both have the common interest in seeing the successful outturn of a project, on time, and within budget.

However, the FD clearly doesn't want to reflect unearned profit whereas the PM will be possibly more bullish as to the potential earnings.

If a project is run on time and within budget, when is it reasonable to take profit? From the start, 20%, 30% or 50%? Measure of a contract performance is a judgement call and open to interpretation. What confidence does the FD need to have before profit recognition takes place? Difficult decisions need to be made and an accounting policy formulated.

Generally, a project will have its unknowns and specific areas of risk – for example, dependence on third parties, the weather, etc.

Clearly it is risky to rely solely on the representations of the PM's. Furthermore, the FD may have their own pressures for the overall performance to meet its financial target.

Variations to contracts create difficulties in acceptance by the client in terms of value and meeting the specifications. Variations can be poorly documented leading to potential issues and uncertainty. Questions on the quality of workmanship may not be highlighted to an FD at the right time.

Monthly progress reports prepared by the PM will be valuable data for an FD. These should show:

- stage of completion
- costs to complete vs. revenue to complete
- variation and expected outcome on those not agreed
- potential upsides v potential downsides

This will help FDs to avoid recognising revenue on contracts where variations have not been agreed.

Additional ways to mitigate potential risks also include:

- Apply financial rigor to key estimates and judgements throughout the project.
- Formulate specific project cashflows from the start, and update regularly to allow for true contingencies.
- Ensure good quality financial information is available so that both the PM and FD have the ability to assess the actual position of a project by reference to contract estimates with clear timescales and milestones.
- Form strong delivery teams, where the FD, PM and other professionals work together in a collegial manner.
- Encouragement by senior management to the production teams to be transparent in their dealings and highlight potential problems as soon as they are identified.
- Withhold performance bonuses until a contract is fully delivered.

Ascertaining the performance of a contract throughout its process is hard to judge. However, good financial systems and robust overview with the professionals operating collectively will help enormously.

Determining compensation for land

Land matters

For many centuries, the purchase of a land has been essential for the economic and social development of a region. We only have to reflect on all the canals, road, railways, electricity generation station, schools and hospitals that have been built, and continue to be built.

The current Crossrail and HS2 projects are a continuation of that history. But it is not just national infrastructure projects that require land to purchase – it is the public and private developers of commercial and residential property as well.

Whether by private agreement or through the powers of compulsory purchase orders, the purchase and development of land owned by others can have a significant impact on the individuals, communities and businesses in situ on a personal and/or commercial level. We have seen this at first hand in our work on HS2, Crossrail and other city centre regeneration projects, whether those affected are a small family business or part of a FTSE-quoted multi-national.

The expropriation of land comes with a cost. Payment to be made to provide financial equivalence for the loss suffered by the landowner. A business owner is entitled to claim compensation for what is called 'disturbance', a somewhat understated legalese.

Depending on the circumstances (and every claim has its own particular nuances) compensation may include elements such as:

1. loss of profit
2. the value of the business as a whole or in part
3. plant & equipment
4. relocation costs
5. double overheads
6. acquisition & fit-out costs of alternative premises.

It is primarily the loss of profit and business value that forensic accountants focus on. They commonly work alongside surveyors and other property and industry experts in assisting both claimant businesses and developer/acquiring authorities on the financial impact of the purchase of commercial property.

Location, location, location

As to the level of compensation due, broadly speaking this flows from the decisions the business makes.
If a business finds itself under order of compulsory purchase, generally it will want to find a way to continue trading, whatever its size. It will strive to find an alternative trading location at the earliest available opportunity to reduce potential losses. Indeed, a business will be under a duty to take all reasonable steps to mitigate such losses.

If the business can relocate, then the losses may prove to be only temporary. However, that is not to say its trading levels could not fall on a longer term and more permanent basis, if the alternative premises are not as suitable.

Comparison of a business where location is critical (such as a retailer and its footfall demands or a distributor dependent on easy access to transport networks) with that where it is typically not (such as a professional services company in a generic office building) shows how important this relocation can be.

If the search for suitable relocation premises falls short, the business cannot relocate and there are no other mitigating possibilities, the business becomes 'extinguished'. It is forced to close and cease trading. Then the compensation is broadly based on the value of the business as a whole, following traditional methodologies and metrics for valuing the same that accountants – not just forensic ones – use.

Compensation

Overall, in considering what compensation is due, the overriding principle is that of 'equivalence'. A business should be in the same position after being acquired as it was before, in monetary terms. It is a common principle within many arenas of compensation (*restitutio in integrum* as the Romans would have it) and aims to ensure that a business (or individual) is compensated fairly and fully for their loss.

Property and infrastructure development remain high on the UK government's agenda – they are here to stay. Indeed, the ubiquitous HS2 continues to garner headlines. Against the backdrop of an increase from the official 2015 estimate of £56bn to over £100bn, the project was approved in February, promising to *'deliver a new anatomy of British transport – a revolution in the nation's public transport provision'*

For a landowner or business that finds its land or premises being compulsorily acquired, it is undoubtedly an unsettling time. And although monetary compensation may be an unwelcome alternative, it is good to know that the root of the process values fairness and compensates for what is lost to get that business back on the right track.

How MHA can help you

We work with BTVK Advisory who are part of the Baker Tilly International network and experts in forensic accounting and advisory services. Whether you need a quantification, an investigation or a valuation, the global team can help you define value in virtually any scenario imaginable.

Property case studies

Mould Contaminates Sterile Environment

A UK pharmaceuticals manufacturer suffered a flood in a sterile production line. Following clean-up and re-start, mould was discovered in the sterile environment, closing two production lines. Some loss of production was mitigated by adapting a newly constructed line to manufacture products from the closed lines. Our review analysed historical sales, market conditions and tenders for new business and prepared alternative loss of profit calculations to assist insurers with the settlement of the claim.

Power Station Construction Delay

A delayed start up claim in excess of £20 million occurred at a power station construction project. Evaluation of the claim required a detailed understanding of the power market and market considerations during the loss and at final completion.

Quantifying Recoverable Assets

Evaluated and reported on accounting systems in connection with a treasury manager who misappropriated £9 million, hidden in "exchange differences". The amount recoverable was quantified through review of the employee's bank statements and trading account at a spread betting firm.

Property pensions

For many individuals involved in property development and investment, the concept of investing into a pension plan to help meet a retirement objective is rarely at the forefront of their mind. Indeed, the word 'pension' is often wrapped up with negative attention in the British media, whilst bricks and mortar are seen more favourably.

This is a real shame as modern pension arrangements are far more flexible than their predecessors. They offer a valuable suite of tax benefits to individuals, which can be particularly beneficial to those who wish to invest in commercial property and/or land.

These tax reliefs include:

1. Corporation tax relief on company pension contributions
2. Personal tax relief at up to an individual's highest marginal rate on personal contributions
3. Tax free returns on investment
4. Value of the pension assets falling outside of an individual's estate for inheritance tax

How does it work?

With today's low interest-rate environment, more and more individuals have old pension pots that are deemed 'frozen', and in their eyes, adding little value.

It is worth considering the merits of transferring these old pension pots to a new scheme that allows commercial property purchase. The employer could then make a lump sum contribution from their business, obtaining some beneficial corporation tax savings. Using the combination of the transferred pension benefits and contribution from the company, it is possible to purchase, or even part purchase, a commercial property with the monies held in the pension.

Once a purchase is made, another possible step is to arrange a lease from the pension fund (which now owns the building) back to the company paying a regular commercial rent. In many circumstances, there isn't much of a saving for the company beyond the initial corporation tax saving from the pension contribution. However, this set up now builds up the individual's pension through regular rent payment – a much better result than paying rent to a third party. Importantly, the rental income in the hands of the pension suffers no tax as it is considered an investment return.

Other variations of this theme include purchasing land which may offer development hope, or, alternatively, using pension funds to purchase commercial property outside of an individual's own business or investment company. Not only does this provide the valuable tax benefits listed to the left, it also provides their company with an excellent source of cash flow.

What type of commercial property types can I purchase?

Shops

Restaurants

Pubs

Warehouses

Factories

Garages

Office blocks

Care homes

What about residential properties?

While you can technically purchase a residential property (such as buy to let property) with your pension fund as well, this would result in substantial tax charges being applied by HMRC which makes the direct purchase of residential properties financially unviable.

What do I need to consider before purchasing a commercial property?

Pros

- There are generous tax reliefs, as detailed before
- Property prices can sometimes outperform other investments
- You will own a physical asset via your pension plan

Cons

- There is no guarantee your property will rise in price
- Your capital is tied up and it may be hard to sell quickly if necessary
- You could face liquidity issues when you try to take benefits
- Repair, maintenance and legal costs can add up
- You may need to take on additional debt to fund the purchase

A financial adviser can be a great help in determining the right steps for your personal circumstances. For the best financial outcomes, it's advisable to speak with a pensions expert before you make a final decision. Professional advice should always be obtained prior to the completion of any transaction.

The Financial Conduct Authority does not regulate some Buy to Let mortgages or Tax Advice.

Latest news

Tax updates

Capital Gains Tax Reporting

A new requirement to report and pay capital gains tax (CGT) on disposals of UK residential property within 30 days of completion applies to disposals made by UK resident taxpayers on or after 6 April 2020. In response to the COVID-19 pandemic the government extended the reporting deadline so that no late filing penalty will be charged for any transactions completed between 6 April 2020 and 1 July 2020 which are reported by 31 July 2020.

Reverse VAT charge postponed

The government announced a further five-month delay to the introduction of the domestic reverse VAT charge for construction services due to the impact of coronavirus. The reverse charge for VAT on construction services was originally due to come into force on 1 October 2019, but its introduction was later pushed back until 1 October 2020. It will now come into effect from 1 March 2021

PPE for employees not taxable

HMRC has confirmed that equipment to protect employees from coronavirus is non-taxable, but reissued guidance suggests that tests purchased by staff and reimbursed by employers may be subject to tax.

News bites

ONS suspends house price index

The ONS has temporarily suspended the UK House Price Index (HPI) publication from the April 2020 index, until further notice. The impact of COVID-19 greatly reduced the amount of housing transactions that took place in April 2020, making it very difficult to produce a measure of UK house prices that would be representative of any true transaction activity within the housing market.

CITB levy

3 months

The Construction Industry Training Board (CITB) confirmed that the three-month suspension of levy contributions announced in March 2020 to help employers recover from COVID-19 will continue until September 2020. Businesses will then have up to a full year to pay the 2020/21 levy, meaning that employers will only have to pay 18 months' rather than 24 months' levy.

New Homes Bill

With 15% of greenhouse gases coming from the residential sector, The New Homes (New Development Standards) Bill will require residential developers to meet minimum standards of provision for insulation as well as broadband connectivity and electric car charging points in new homes. The bill, which had its first hearing in the House of Commons on 30 June 2020, will help the government achieve its ambitious net zero carbon emissions target by 2050.

Shake up of planning laws

Under a radical shake-up of planning laws, land will be designated into three categories:

1. **Growth areas** will get automatic approval for new homes, hospitals, schools and offices.
2. **Renewal areas** will get "permission in principle", to allow for appropriate checks.
3. **Protection areas** will be banned from development.

MHA Construction Sector Report coming soon!

Look out for the MHA Construction Report, due out in Autumn 2020.

Following our national survey earlier in the summer, the MHA Construction & Real Estate specialist team will release a report integrating both the results of the survey and financial data for benchmarking purposes. The report will look at the state of the construction sector going into the COVID pandemic, analyse how the sector is responding to current challenges, and anticipate the way forward for the industry.

The report will cover:

- COVID-19
- Funding
- Recruitment and employment
- Innovation
- Looking forward to the future

Be sure to follow MHA on the following social media platforms to find out more:

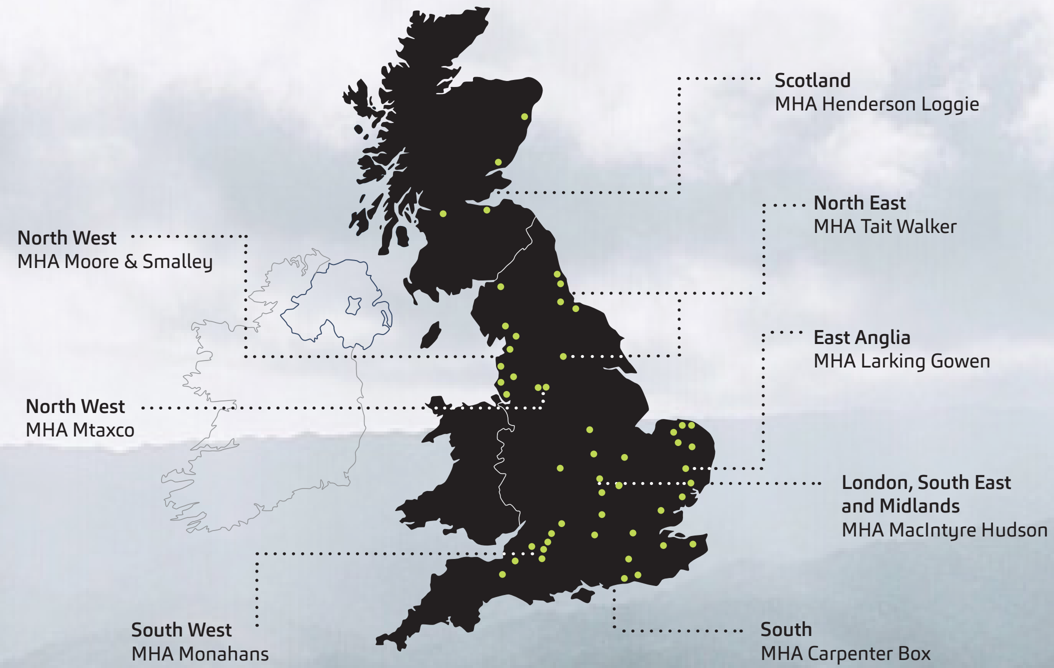
Or visit www.mha-uk.co.uk for the latest Construction & Real Estate insight.

About MHA

MHA is an association of progressive and respected accountancy and advisory firms with offices in over 50 locations across the UK. We provide both national expertise and local insight to clients. As an independent member of Baker Tilly International, a top 10 global advisory network, MHA offers clients unparalleled access to a broad range of in-country international specialists where overseas projects are on the horizon.

Our Sector Approach

MHA allows clients to benefit from in depth sector knowledge in addition to specialist accountancy services and expert business advice. Construction and Real Estate is a key sector for MHA, and our industry experts understand the challenges and opportunities within the sector. With MHA's sector experience, and local, national and international knowledge, our team is well placed to provide leading advice.



National Reach

50+
Offices nationwide

International Reach

125
Member firms in 145 territories

Combined turnover of
£143m

8
Independent accountancy firms

10th
Largest network in the world by combined revenue

US$3.6bn
Combined member firm revenues

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