HOMES FOR THE SOUTH WEST

Submission to the Residential Property Developer Tax consultation: June 2021

Thank you for the opportunity to contribute to the Government's thinking ahead of the proposed residential property developer tax.

About us

We are Homes for the South West, an alliance of 11 Housing Associations operating in the South West region.

Collectively we own 250,000 homes, we house half a million people, and our businesses make an annual contribution of £1bn to the local economy.
We build homes of all tenures, but affordable homes, homes for rent, for those in need and unable to afford the market, are the reason we exist.
Despite the challenges of recent months and years we remain resilient businesses and are in a position to meet the challenges ahead. We are ready to build 25,000 homes over next 5 years, and to invest £4bn in doing so.

Our response to consultation on Residential property developer tax – affordable housing

This tax is intended to impact on the largest residential property developers to help fund the rectification of cladding issues on residential developments. Whilst many Registered Providers of affordable housing (RP's) may fall under the £25m threshold for this tax, there is a risk that over time more developing RP's may be caught by this tax. There is also a risk of significant compliance costs for RP's to determine the notional profit from development and prove that they do not fall within the scope of the tax. These costs will reduce RP's financial capacity and the viability on providing affordable housing, which in turn will reduce the supply of new affordable housing at time of unprecedented demand. RPs principal business is managing affordable rented housing and, as such, already contributing significantly to provision of this tenure.

The provision of new affordable housing is not financially viable unless subsidised by way of discounted purchase price (s106 homes) or via grant funding. Some RP's operate cross subsidy models e.g. by developing homes for market sale or provision of student housing to help bridge the financial viability gap.

The provision of this tax onto RP's will raise a minimal amount of tax, but together with the compliance costs will have a detrimental impact on provision of affordable housing. The best solution for all parties is a carve out of Non-Profit RP's from the legislation, as they are unable to distribute profits to shareholders. This would include For Profit subsidiaries wholly owned by a Non-Profit RP, as any profits generated by these companies are used to cross subsidise affordable housing and are effectively ring fenced within the social housing sector, whether that is via gift aid donations or being retained in the subsidiary to build up reserves.

Without a carve out for Non-Profit RP groups there are a lot of technical issues to be resolved to implement the tax. The following are some of the points to be considered:

1. *Determination of Developer status*
   RP's acquire new affordable housing from three main sources:
   i. S106 requirements on developers of new residential sites to provide a certain amount of affordable housing
   ii. Purchase of homes direct from developers using grant funding. These may be homes that were intended for market sale.
   iii. Own development, often by way of a main contractor, on land purchased by an RP with grant funding.

   It is assumed that homes purchased from another developer (i & ii), under a s106 agreement or developed completed homes, then the tax burden will fall onto the developer. However, it is important to note that many RP's operate an arrangement for shared ownership homes to be transferred before first grant of major interest enabling the sale to the shared owner to be zero rated rather than exempt for VAT. This does raise the technical question of how an organisation is classified as a developer.

   The current drive from Homes England is for RP's to purchase land and build new homes to create a real increase in new homes rather than appropriating homes already being developed for market sale. This will result in more RP's being developers, with homes being retained for rent or sold as shared ownership. Depending on the determination of profit this could bring more RP's into the scope of the tax.

2. *Definition of profit*
   The determination of market sale profits is relatively straight forward as all the sales are booked to the Statement of Comprehensive Income creating a profit or loss. This becomes more complicated when assets are developed to be held for long term rental. There are several different types of valuation used for affordable properties:
   - Purchase cost – this is often the value held in the accounts
   - Fair value – accounts value prepared by a professional valuer
   - Loan security value – the two most common types are:
     - Existing Use Value (EUV-SH) based on future social rental income

- Market Value Subject To Tenancies (MV-STT) based on future rent with market sale disposals

These different valuations methods result in materially different values. For example, EUV-SH will result in significant losses on each property developed.

If RP's have to engage professional valuers to determine the value of rental stock to determine a notional profit it will add significant additional costs. This will reduce the supply of affordable housing in return for minimal tax generated.

3. *Treatment of Grant funding*
Grant funding for affordable housing is provided by Local Authorities and Homes England in acknowledgement that without this funding the provision of affordable housing via non s106 land led is not viable. If the grant is deducted from the cost in the determination of any notional profit or actual profit on shared ownership sales, then this will reduce the viability. This in turn will reduce the provision of new affordable housing, which is contrary to the purpose of grant funding. If properties are sold for non-affordable housing, then the grant has to be recycled into new affordable housing or repaid. It is recommended that grant is excluded from any calculation of notional profit.

4. *Gift Aided profits from wholly owned For Profit subsidiaries*
Many RP's conduct commercial activities in wholly owned For Profit subsidiaries or Joint Ventures to separate the risk from the charity. The purpose of these commercial activities is to provide income to the charity so that it can further its charitable activities.

   Many RP's gift aid all the profits made in these companies back to the charity. Consideration is required into how RDPT and gift aid will interact to avoid any profits that cannot be relieved by gift aid.

5. *Losses brought forward*
The creation of a new company can result in losses in the early years as it is established. This is due to the set up costs for new business and the interest cost of holding land financed on debt until it is developed. It is therefore important that brought forward losses are allowed in the calculation of RDPT.

6. *Development Viability*
The levying of this tax will hit the viability of developments on those developers paying the tax. There is a risk that this reduces the provision of new affordable housing. This could be by developers increasing the price for affordable housing making it unviable or developers seeking to reduce the provision of affordable homes in the s106 agreement on viability grounds.

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7. *Tax Model*
   The preferred tax model is Model 2 - activity based approach. This is due to the wide variety of activities that RP's undertake, many of which would not fall under the scope of the tax.

Conclusion

RDPT will raise a minimum amount of tax from RP's but have a negative impact on the provision of affordable housing. The increased tax compliance costs will reduce financial capacity and the viability for new affordable housing. We recommend that Not for Profit Registered Providers and their wholly owned subsidiaries are excluded from this tax.

Thank you again for the opportunity to contribute to this propsal and, on behalf of Homes for the South West, please contact me if there is anything above you would like to explore further.

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