Response to the call for input for the HM Treasury review of the UK's funds regime

Submitted by email to ukfundsreview@hmtreasury.gov.uk

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Introduction

The Commercial Real Estate Finance Council (**CREFC**) Europe is a trade association promoting a diversified, sustainable and flourishing commercial real estate (**CRE**) finance market in Europe that can support the real economy without threatening financial stability. Our membership includes a range of different bank and non-bank lenders (including credit funds), passive investors in CRE debt, intermediaries and advisory businesses, as well as real estate firms that use debt to finance their activities.

We are responding to this call for input principally from the point of view of the CRE debt funds that have become such an important part of the supply of credit to the UK's CRE industry in the years since the GFC. Importantly, our focus is not only on measures that might make the UK a more attractive jurisdiction of choice for the location of fund management and fund administration activities of existing firms. We have also taken this opportunity to identify new vehicles that would in our view add to the options available to investors for gaining exposure to diversified CRE credit risk and returns. We believe there are significant collateral benefits to be gained from this broader approach in terms of enhancing the transparency, stability and resilience of the UK's CRE finance market and access to credit for real estate firms.

Please contact Peter Cosmetatos, chief executive of CREFC Europe, to discuss any of the points raised in this submission in more detail, on 07931 588451 or at pcosmetatos@crefceuope.org.

General comments

CRE is an important investment asset class that also defines our towns and cities. Buildings last a long time, and can be costly and difficult to adapt to changing social, technological and economic needs. In 2021, we face structural disruption from e-commerce (to our high streets and how we shop), from the pandemic (to how and where we live and work), and from climate change (demanding a rapid reduction in our impact on the environment). The need for productive investment in our buildings over the coming years will be immense, with opportunities for different risk appetites and investment horizons. The nature of CRE as an asset class means that debt is an important part of the capital stack alongside equity. A good range of user-friendly fund structures allowing capital of different kinds and from different sources to be aggregated and invested in illiquid but inherently productivity-enhancing assets would be good for the UK's built environment, economy and society as well as for its fund management industry.

In the persistently low interest rate environment of recent years (and against the backdrop of serious structural challenges for real estate markets), CRE debt has been an increasingly popular allocation for investors. CRE debt offers a yield premium as compared to similar credit risk in other parts of the fixed income universe, reflecting the relative illiquidity of CRE debt. At the same time, it benefits from security over real assets, trading the potential upside available to the real estate investor in favour of protection from the downside (as the real estate investor will take the first loss).

In recent years, following the disruption and trauma of the GFC, the UK's CRE finance market has become much more diverse, settling somewhere between the highly diverse US market and the largely bank

dominated markets of the Eurozone. Non-bank lenders now account for roughly 25% of UK CRE lending, while UK banks and building societies are responsible for 40% or so (with international banks making up the difference).[1]

That diversity of credit supply for real estate helps ensure that there is access to capital for a very broad range of UK commercial buildings and their owners. That is important, because the need for productive investment to deliver decarbonisation, levelling up and the repurposing of buildings that are no longer fit for purpose spans geographies and sectors, ticket sizes and risk appetites. Diversity of credit supply is also good for financial stability, as the market is not overly dependent on a single type of lender likely to offer similar products, pursue similar strategies and respond to market signals in the same way. Having said that, the UK CRE debt market offers few investment channels even for institutional investors, and limited market transparency: a market dominated by privately held loans generates little comparable data to support investment decisions.

In the US, the commercial mortgage-backed securities (**CMBS**) market supports a large amount of lending on behalf of a broad universe of debt investors. As a result, the CMBS market provides not only good liquidity and investment opportunities for different risk/return appetites, but also timely and comparable market information that can serve as a useful proxy for the CRE debt market as a whole. For a variety of reasons mostly linked to the GFC and the regulatory response to it, CMBS unfortunately accounts for only a small share of the market in the UK (and Europe), so cannot perform the same role here.[2]

Another feature of the US market that is missing in the UK is mortgage real estate investment trusts (**Mortgage REITs** or **M-REITs**). These are listed vehicles with permanent capital that specialise in secured CRE lending to generate stable, long-term income for their shareholders. A large Mortgage REIT market addresses investor liquidity through secondary market trading. Importantly, the permanent capital of a Mortgage REIT allows it to manage the maturity profile of its loans to minimise its exposure to the property cycle[3] with much greater flexibility than investment structures with a fixed maturity date (such as CMBS and most CRE debt funds).

Mortgage REITs could also provide two additional benefits to the wider UK CRE finance market: first, they might be natural buyers of CMBS risk tranches (thus adding to the liquidity of the CMBS market); and secondly, they should have broader access to debt capital markets for their own leverage than tends to be available to CRE debt funds as currently structured (reducing cost while adding transparency to an aspect of the CRE finance market that is currently especially opaque).

In the absence of a more substantial CMBS market or a Mortgage REIT market, investors specifically seeking diversified CRE exposure have few options short of creating a substantial CRE loan origination business of their own. The simplest solution is to allocate capital to a specialist CRE debt fund manager.[4] Our understanding is that most CRE debt funds use offshore structures, most commonly in Luxembourg, though

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[1] According to data from the mid-year 2020 edition of the Commercial Real Estate Lending Report compiled by the Business School (formerly Cass).

[2] The lack of such market data is a driver for the Bank of England's continuing support for an industry led initiative to deliver a CRE loan database along the lines recommended by the 2014 independent industry report, *A Vision for Real Estate Finance in the UK* (available at https://www.ipf.org.uk/resourceLibrary/a-vision-for-real-estate-finance-in-the-uk--may-2014-.html – see recommendation 1).

[3] The risk that the property cycle nevertheless poses for lenders is a central concern of *A Vision for Real Estate Finance in the UK*, referenced in footnote 2 above.

[4] It is also possible to invest in loans originated by others in the syndication market (though the loan-by-loan nature of this approach means achieving diversification involves large sums and multiple investments). Another option is to enter into a segregated account with a specialist firm that has origination capability. For present purposes, the focus is on collective investment and therefore funds.

Irish and Channel Islands vehicles are also used. A few managers have tried to form Mortgage REIT-like vehicles offshore, but most CRE debt funds are private, closed-ended, limited life, institutional funds.

Building on that background, we see two big opportunities in this review:

- First, it may be possible to tempt CRE debt fund managers to form new CRE debt funds in the UK rather than offshore, bringing jobs back to the UK and reducing frictional costs associated with offshore structuring. For this strategy to succeed, the UK would have to at least match the tax and regulatory outcomes, as well as the speed to market, administrative ease and predictability, currently available in the leading funds jurisdictions. The long-term asset fund (**LTAF**) and professional investor fund (**PIF**) discussed below could go a long way to promoting productive and long-term investment in the UK's built environment with the fund management and administration jobs more likely to be conducted within the UK.

- Secondly, the UK could expand its existing REIT framework to accommodate Mortgage REITs, to the benefit of investors, financial stability and the real economy. Listed M-REITs are inherently compatible with the illiquid nature of the underlying investments (investor liquidity is available through trading on the secondary market), resilient to the property cycle (permanent capital allows greater flexibility to manage loan maturity dates), and consistent with the 'income distribution machine' REIT concept (perhaps more so than some of the UK's existing REITs). Allowing such vehicles to be formed straightforwardly in the UK would keep more jobs in the UK, and remove the frictional costs and complexity of having to use offshore structures. That would in turn make it easier for M-REITs to build the scale required to allow them to fulfil their potential.

Detailed responses to questions

Chapter 1 Introduction

Next steps

1. This call for input on the UK funds regime is necessarily wide-ranging. As the government would not be able to take forward all proposals immediately, what do you think the top 3 priority proposals should be for government implementation and why?

We welcome the overarching objective of the review to identify ways in which the UK might be made a more attractive location to set up, manage and administer funds, and which will support a wider range of more efficient investments better suited to investors' needs. We also welcome the explicit linking of this agenda to the need to encourage productive investment within the UK. A great deal of vital productive investment is linked to illiquid asset classes such as infrastructure, CRE and associated credit, so it is important to ensure that a good range of suitable opportunities exist for pooled investment into such illiquids.

The government agenda for levelling up across the whole of the UK, to support local economic growth and employment, to regenerate our town centres and high streets and to improve local infrastructure will not be achieved without very significant private sector investment, which must include lending to finance real estate and infrastructure investment.

We would see the top three priorities (discussed in more detail below) as:

- the introduction of the LTAF,

- the introduction of the PIF (on a flexible basis), and

- the introduction of Mortgage REITs.

The introduction of the LTAF

The LTAF concept developed by the Investment Association (**IA**) is a new fund structure allowing wider access to less liquid assets. It has been designed to be particularly accessible for defined contribution (**DC**) pension schemes but should also be available for certain individual investors. The LTAF is designed to allow investments in a wide range of less liquid assets, but of particular importance is the ability to open up to qualifying investors a broader range of options for investment in real assets (real estate and infrastructure). Defined benefit pension schemes and life insurance companies have in recent years become major long-term lenders to real estate and infrastructure, some of the larger ones directly and others through specialist funds (as outlined in our general comments above). The LTAF can facilitate this opportunity for DC and appropriate individual investors. We believe that this is crucial for long-term investment in view of the increasing proportion of retirement capital that is held in DC schemes and individual investment arrangements. The changes introduced in the Pensions Act 2021 will accelerate this trend.

We are aware of and support the submissions of AIMA, AREF, BPF, INREV and IPF in support of the LTAF for a broad range of assets, but our own submissions focus on the potential of the LTAF specifically in the context of CRE debt funds and CRE credit markets more broadly.

The introduction of the PIF

The UK funds regime currently suffers from a major gap. The Authorised Contractual Scheme (**ACS**) has proved to be popular but it is required to be open-ended and comes with a regulatory regime that is regarded as unduly burdensome by institutional investors.

The PIF could be used by CRE debt funds to lend inside or outside the UK. PIFs could usefully complement the LTAF proposals, on the basis that a PIF investing in illiquid underlying assets such as real estate or real estate debt can itself be seen as an illiquid investment for the LTAF. Funds pooled in an LTAF could be invested in different underlying PIFs managed by specialist managers with expertise in a specific type of asset or investment strategy. The attractiveness of the PIF, particularly for investment in non-UK assets, would to some degree depend on the proposals separately under discussion for a UK asset holding company (**AHC**) regime.

We are aware of and support the submissions of AIMA, AREF, BPF, INREV and IPF in support of the PIF for a broad range of assets, but our own submissions focus on the potential of the PIF specifically in the context of CRE debt funds and CRE credit markets more broadly.

The introduction of Mortgage REITs

The UK's existing REIT framework to allow specialist Mortgage REITs to make and hold loans to commercial property businesses. Mortgage REITs exist in the United States so the concept is globally recognised, but the detailed rules for UK Mortgage REITs should be based on the UK's existing REIT rules (not least, for example, because it would not be desirable for the UK to see very highly leveraged residential mortgage REITs of the kind that exist within the US REIT universe).

UK Mortgage REITs could be created relatively simply, by allowing CRE loans and payments arising under them to count as qualifying assets and income respectively for the purposes of the balance of business test. There are at least three fundamental benefits that a Mortgage REIT structure could bring – all of which are enhanced with scale.

First, secondary market trading would address investors' liquidity requirements (an alternative approach to managing redemption arrangements in the context of open-ended funds investing in illiquid assets). This would work in the same way as for the UK's existing REITs, and pricing information from M-REITs would provide useful data for the wider CRE debt market, just as pricing information from the UK's existing REITs provides useful data for the wider CRE market.

Secondly, unlike the generally private, limited life, closed-ended funds that dominate the CRE alternative lending market, M-REITs would have an unlimited life and could therefore have permanent capital. That would allow them to manage their exposure to the property cycle in a way that CMBS portfolios and limited life debt funds cannot: by staggering the maturity profile of their loans to ensure that a period of market stress should not affect the whole book or the stability of the firm as a whole.

Thirdly, M-REITs would provide market data and insight into the UK's CRE debt market, helping market participants and investors make decisions. A similar role is played by CMBS in the US CRE debt market, and by the UK's REITs in the UK property market.

Those fund managers and investors that have sought to create a structure with such characteristics have had to do so offshore, with the associated frictional costs and complexity – and that has added to the difficulty of achieving scale. Scale, and the benefits outlined above, would be much easier to realise – both for individual fund managers, investors and funds, and at a market level – with a simple, internationally recognisable, UK-based vehicle.

It should be noted that the introduction of UK Mortgage REITs would be a substantive expansion of the UK REIT regime, allowing the globally recognised REIT framework to accommodate a different set of real estate-focused managers (those with credit expertise). The change we propose would be unlikely to benefit the UK's existing REITs, as they are not especially likely to set up M-REITs themselves, or to be natural borrowers from M-REITs (REITs generally already have very good access to credit markets). However, the introduction of UK M-REITs would add choice for investors in and managers of CRE debt funds, with the potential to improve CRE debt market transparency and stability, and access to credit for real estate firms, to the benefit of financial stability and productive investment in the UK.

Chapter 2 The UK's approach to funds taxation

Current funds landscape

2. How effective were recent reforms to UK funds taxation in achieving their aims? Please explain your answer. Could anything have made these reforms more effective, particularly in terms of increasing the attractiveness of the UK as a location to set up funds?

The introduction of the UK's REIT and PAIF regimes for real estate investment were in our view important and successful, as were subsequent steps to add flexibility and broaden the appeal of UK REITs. We see a similarity between the use of offshore structures to mimic REIT outcomes before the introduction of the UK REIT regime in 2007, and the use of offshore structures today to mimic the outcomes that might be achieved by UK Mortgage REITs (though missing, in the case of M-REITs, is a group of onshore listed entities for which conversion can ensure immediate take-up).

However, there are established regimes with funds-friendly tax and regulatory environments and user-friendly administration that are already familiar to fund managers and investors (Luxembourg, and more recently Ireland, as well as offshore jurisdictions). It is our understanding that CRE debt funds are typically set up using such jurisdictions. For the UK to displace those in popularity, it needs to at least match their advantages, with a good level of simplicity and certainty across all relevant tax and regulatory aspects.

For fund managers wishing to market their products to EU investors in multiple member states, it may be that Luxembourg or Ireland would remain the jurisdiction of choice because of the EU passporting it would allow. However, for fund managers raising capital from other jurisdictions (and/or from only a small number of EU member states, such that the use of private placement regimes is a workable solution), a UK solution that matched the tax and regulatory benefits of the familiar alternatives would be attractive, removing frictional costs and hassle.

Scope for change: Multi-asset / balanced authorised funds

3. Why has uptake of TEFs been limited? Please explain any operational or commercial factors that have influenced their uptake. How could these be addressed?

No comment.

4. How would the proposals in paragraph 2.9 improve tax efficiency of multi-asset authorised funds? Please explain how the proposals would work in practice and how a proportionate impact on HMRC could be ensured.

No comment.

5. Are there any additional changes the government could consider to reduce tax leakage in multi-asset/balanced authorised funds?

No comment.

Scope for change: Tax-exempt fund

6. Where funds are already tax neutral, how would a tax-exempt status for funds influence decisions about how and where to set up funds?

Tax exemption provides a simple regime for managers to use and investors to understand, compared to the current, complex UK route to tax neutrality for authorised funds, which is more difficult to navigate and more complicated to explain to investors. Tax-exempt status would provide greater certainty and clarity. However, tax exempt status alone would not drive broad international take-up of these funds.

7. How would tax-exempt funds affect the competitiveness and attractiveness of the UK funds regime? Please explain your answer providing evidence and international comparisons where possible.

The option to create tax-exempt funds would make the UK funds regime more attractive and competitive, especially given that tax exemption is the status quo in established fund domiciles like Luxembourg and Ireland, as well as in emerging fund domiciles such as Gibraltar, Singapore and Hong Kong.

While access to tax treaties is not generally available to tax-exempt funds, this has been negotiated by some countries (e.g. Singapore provides a tax residency certificate) while others provide reliefs on broader domestic principles (e.g. the existence of tax information exchange arrangements). In Ireland, we understand that funds can access certain treaty benefits on the basis that they could be subject to tax if they had certain non-exempt Irish investors.

More generally, tax-exempt funds may not be suitable in all cases, so it would be preferable for the funds regime to provide tax exempt fund structures alongside tax transparent and taxable structures, and/or tax exemption but with the option to be taxable.

Scope for change: Real Estate Investment Trusts

8. What would be the likely impact if changes were made to the REIT regime in the areas discussed in paragraph 2.16? To what extent could investment in the UK be expected to increase, and what would be the drivers for this? Could such changes be expected to impact the extent to which funds with UK and foreign property assets are manage in the UK?

Given our focus on the CRE debt market, we are not in a position to comment on the existing UK REIT regime. Our representations concentrate instead on the case for building on that regime to accommodate UK Mortgage REITs. We would be inclined to support the submissions of AREF, BPF and INREV in relation to

other aspects of the REIT rules, on the basis that expanding and making more flexible the range of UK real estate investment vehicles should be positive for the UK real estate market, making it easier to channel more capital into the UK built environment at a time when it requires considerable capital expenditure.

9. Are there any other reforms to the REIT regime that the government ought to consider, and why?

The introduction of Mortgage REITs would be a simple but substantive extension of the UK's current REIT regime, rather than incremental reform. At a technical level, it would involve changing the balance of business test to treat CRE loans as qualifying assets and the interest and other payments arising under them as qualifying income. In this way, the UK could create a listed vehicle with a globally recognised brand, subject to all the other protections inherent in the REIT regime (including leverage limits), allowing CRE debt investment using permanent capital and liquidity through the secondary market.

We refer you to our general comments and our response to Q1 above for a little more detail, and would be delighted to work with officials to consider the detail of how UK M-REITs might become a reality.

Scope for change: Treaty issues

10. Regarding the proposals covered in this call for input, are there any specific considerations that the government ought to take account of in the context of the UK's double taxation treaty network? Please provide as much detail as possible.

A good network of double tax treaties, ideally providing for zero withholding tax, is a very important feature of successful funds jurisdictions. For CRE debt funds in particular, treaty eligibility is important if the borrower source jurisdiction imposes withholding tax on interest (which may not always be the case), and/or in relation to payments to investors located in other jurisdictions (to the extent they take the form of interest).

The UK should seek to provide clarity of application of double tax treaties to funds, including a clear policy in relation to the application of the recently introduced principal purpose test. Efforts should be made to ensure that treaties apply to funds which are tax exempt or are not "persons" in the normal sense when renegotiating existing treaties.

Scope for change: Limited partnership funds

11. What are the barriers to the use of UK-domiciled LP Funds and PFLPs, and how might tax changes help to address them? Please provide detailed proposals to explain your answers.

Many of the barriers are largely legal and regulatory – comparisons should be made with the regimes in Ireland and Luxembourg. From the tax perspective, it would be valuable to clarify (and perhaps simplify) existing rules with respect to the filing of tax returns and potentially the capital gains tax rules for UK resident investors. We would also highlight the problem of potential stamp duty charges discussed in our response to the AHC consultation.

In addition, the UK rules in the following areas might usefully be reviewed to modernise UK limited partnerships and bring them into line with competitor jurisdictions.

- **whether or not English or other limited partnerships should have legal personality:** the successful Scottish limited partnership regime could be extended to England and Wales to compete with the increasingly popular Luxembourg special limited partnership (SCSp). As we understand it, Scottish-style limited partnerships can enter into agreements, hold assets in their own name and take action against a counterparty in order to protect their assets.
- **the creation of compartments and 'vintages' within limited partnership structures:** it would be interesting to see a UK structure similar to the very popular Luxembourg RAIF. Such a structure would

allow investors participating in the same pool of investments to do so on distinct terms without having to form a separate vehicle (such as a feeder or parallel fund). These types of umbrella arrangements are becoming increasingly common for a variety of reasons, giving managers more flexibility to invest in different assets. If the UK is to compete with comparable Irish or Luxembourg structures, consideration should be given to allowing assets to be siloed or ring-fenced from the liabilities associated with assets in different investment compartments. The UK could also explicitly allow the creation of contractually segregated vintages within such compartments to add further flexibility for asset managers and investors (as we understand was recently enacted in the Gibraltar funds regime).

- **removal of the requirement to submit notice of transfer or change of the general partner to the London or Scottish Gazette:** it is unclear what public interest remains for such details to be made public for those limited partnerships still subject to this requirement (it no longer applies to private fund limited partnerships (**PFLPs**)). Failure to make a submission to one of the Gazettes may jeopardise the validity of any transfer or removal and adversely impact the status of a limited partnership.

- **extension of the whitelist of what limited partners can do without risk to their status:** only limited partners in PFLPs currently automatically benefit from the whitelist. For limited partners in other limited partnerships, it is necessary to refer to the constitutional documents of the limited partnership or indeed to the Limited Partnership Act 1907. Consistency across all limited partnerships as to what limited partners may do would be welcome, following the likes of Jersey and Luxembourg.

- **transparency on more favourable rights:** we understand that Luxembourg law requires that the constitutional documents specify what may constitute more favourable rights. Until such time as the AIFMD is disapplied under UK law, a requirement along similar lines would reduce uncertainty as to whether or not disclosure is required under the AIFMD.

Chapter 3 The UK's approach to funds regulation

Scope for change: Fund authorisation

12. What benefit does fund authorisation bring to product providers beyond access to retail investors? Does this benefit vary depending on the specific investor base or investment strategy? What relevance does authorisation of a product have to its appeal to the UK market and to the international market?

CRE debt funds of the kind managed by CREFC Europe member firms tend to be for institutional and professional investors only. As far as we are aware, UK CRE debt funds accordingly tend not to be authorised (though the fund manager may be authorised under the AIFMD regime). We are not aware of any reason for changing that situation.

We agree with the point made by other respondents that terms like "unauthorised" and "unregulated" seem unnecessarily prejudicial in the context of the institutional investor market, and can end up causing confusion for the retail investors they seek primarily to protect.

Scope for change: Speed to market

13. Do you have views on the current authorisation processes set out in legislation and how they could be improved?

To the extent that authorisation applies for funds aimed solely at institutional and professional investors, a process that facilitates speed to market is important – and that is an area where competitor jurisdictions have established very high standards.

14. How do the FCA's timescales for fund authorisation compare internationally? Is there value in providing greater certainty about these timescales? Other than by reducing the statutory limit, how could this be achieved and what benefits would it bring?

See response to Q13. We agree with the points made by INREV in their submissions.

Scope for change: Qualified Investor Scheme

15. What would you like the QIS structure to enable you to do that is not currently possible? What are the existing impediments to your suggested strategies, and why would the QIS be the preferred UK structure for those strategies?

No comment.

16. Do you think that the range of QIS permitted investments should be expanded? If so, in what way should it be expanded, what impact would this have, and would it still be appropriate for sophisticated retail investors?

No comment.

17. Do you think that the QIS borrowing cap should be raised or QIS constraints on derivatives exposure should be relaxed? If so, to what magnitude and why? Would this be appropriate for sophisticated retail investors?

No comment.

18. Do you agree that the QIS sub-fund structure could be improved? If so, how? Would greater clarity for the segregation of assets between sub-funds via legislation or rules be helpful? Please provide details.

No comment.

Chapter 4 Opportunities for wider reform

Defining areas of opportunity

19. Do you agree that reforms to enhance the attractiveness of the UK funds regime should focus on appealing to the creation of entirely new funds that have not yet been set up?

Where (as in the CRE debt fund market) permanent life fund vehicles are rare, it is unlikely to make sense to restructure and relocate an existing vehicle with a limited life from a jurisdiction that meets its needs (although we would not be opposed to suggestions made by other respondents in favour of redomiciliation mechanisms and seeding relief, as such measures can boost early take-up).

Specialist CRE debt fund managers typically raise successive funds over time, with each fund normally having a fixed life of several years (in line with common practice for private equity and real estate funds). Many investors will be repeat customers in successive funds. Persuading a fund manager and investors that the next fund should use a different structure and jurisdiction than what they are familiar with is likely to be a considerable challenge as it is – the UK's pull factors will have to be very strong in the absence of push factors driving funds away from current jurisdictions of choice.

20. Why do firms choose to locate their funds in other jurisdictions in cases where the UK funds regime has a comparable offering, for example ETFs? Are there steps which could help to address this following the

potential reforms to the UK funds regime discussed in this call for input, and would the scope to address this vary depending on the type of fund or target investor market?

For the types of funds used for CRE debt, the UK does not have a comparable offering. We are aware that UK-based CRE debt fund managers typically use Luxembourg structures for private institutional funds (with which a UK PIF could compete). We are also aware that a handful of CRE debt fund managers seeking the characteristics that might be offered by a UK Mortgage REIT regime use offshore structures (again, in the absence of an actual UK Mortgage REIT regime). We suspect the need to use offshore structures has made it more difficult for those funds to build the desired scale and liquidity.

Once fund managers and investors are familiar with a particular jurisdiction and comfortable with what it offers, quite compelling pull or push factors need to exist in order for them to change. While we think that sets the bar very high for the UK to compete with Luxembourg RAIFs and Irish QIAIFs, the creation of UK Mortgage REITs could be an easier sell (noting, however, that this is an investment format that, while successful at scale in the US, has so far been something of a minority pursuit here).

Finally, as noted, for funds seeking to raise capital from a large number of EU27 jurisdictions, the passporting available to Luxembourg and Ireland based structures may be a decisive additional benefit (on top of their attractive tax and regulatory treatment) with which the UK cannot easily compete.

21. Do you agree that reforms to enhance the attractiveness of the UK funds regime should focus on appealing to AIFs targeting international markets? Which markets would be most valuable and what would be the key obstacles to overcome in each?

The UK has played an important role in the emergence of CRE debt funds in Europe – whether investing in the UK or more broadly across Europe and beyond, and whether raising capital from UK, European or global investors (the two ways in which international markets may be targeted). However, the structures created to operate CRE debt funds have generally been offshore (even for UK-targeted funds). In principle, a UK funds regime that works in tax and regulatory terms at least as well as those of Luxembourg or Ireland for example could appeal to CRE debt funds regardless of where they invest, and that should be the objective.

Similarly, the right tax and regulatory environment should aim to appeal to investors globally. As noted, for fund managers marketing their funds in multiple EU member states, the value of EU passporting conferred by locating in an EU member state may outweigh other considerations favouring the UK. Relying on national private placement regimes may be an acceptable cost of locating in the UK where the fund manager is raising capital in no more than a small number of EU jurisdictions (and elsewhere).

We would expect the considerations for M-REITs to be similar to those for UK REITs more generally. There may be an advantage here for the UK insofar as we are not aware that any other jurisdiction offers an simple equivalent for UK and European markets.

Spreading the benefits of fund administration across the UK

22. Do you agree that new UK fund administration jobs associated with new UK funds would be likely to locate outside London? How could the government encourage fund administration providers to locate jobs in specific UK regions?

It is likely that such jobs would be located in places with lower costs than London, but the UK regions would presumably be competing with other lower cost jurisdictions where the workforce has the right education and skills, across Europe and beyond.

23. How can the government ensure the UK offers the right expertise for fund administration activity?

We would endorse the suggestions made in AREF's submissions.

Enhancing existing fund structures: Investment Trust Companies

24. Are there specific barriers to the use of ITCs, either from the perspective of firms creating fund products or from the perspective of investors seeking to access them? Are there specific steps which could address these?

We have not managed to explore this question fully, but it strikes us that M-REITs would have the benefit of a brand and concept globally recognised by institutional and professional investors (who are to the best of our understanding the overwhelming sources of capital in UK and European CRE debt funds). ITCs may not be an obvious choice of vehicle for CRE debt given the more domestic and retail investor orientation we understand ITCs to have.

25. Should asset managers be required to justify their use of either closed-ended or open-ended structures? How effective might this requirement be, and what are the advantages or disadvantages of this approach?

We do not think there should be such a requirement. CRE debt funds are usually closed-ended. As they typically involve a relatively small number of sophisticated and institutional investors, we would expect investors to have appropriate influence over structuring choices, having regard to the investment strategy of the fund and the recommendations of the fund manager. It is not clear to us to whom CRE debt fund managers might be required to justify such choices, or what the benefits of such a requirement would be; on the other hand, the potential downside in terms of costs, time and administrative hassle seem obvious.

Enhancing existing fund structures: Distribution of capital

26. Should the distribution of capital be permitted? What types of products would this facilitate and what investment or financial planning objectives would they meet for investors? What are the possible advantages, disadvantages and risks for investors?

In the context of CRE debt funds, the most usual case where a fund pays capital to investors is where the fund is returning investors' capital after lending it out and receiving it back from borrowers. Such returns of capital should of course be permitted.

27. How do you consider that such a change might be delivered? Please explain your answer, providing specific examples of rules, how they could be changed, and the effect of the changes.

No comments.

New fund structures: Long-Term Asset Fund

28. Do you foresee any issues with the LTAF adopting the current tax rules for authorised investment funds? Would the nature of an LTAF's investments, and the tax treatment of the income it receives in respect of those investments, mean that the current rules for authorised funds lead to tax inefficient outcomes?

As we understand it, constituting the LTAF as a QIS or a NURS would likely result in it being attractive only to UK investors. The existing tax rules are complex and can result in tax inefficiencies in the case of mixed funds (i.e. those investing in a mix of equity and debt assets).

29. Are there any other tax considerations, outside of those that flow from the adoption of the current tax rules for authorised funds, that will be important to the success of the LTAF? Please explain your answer.

UK withholding tax on interest and other amounts should be minimised. A solution is needed for VAT on management fees.

New fund structures: Tax

30. How would each of the proposed unauthorised fund structures add value alongside existing authorised and unauthorised UK fund structures, including the QIS? Would they bring value alongside each other? Would they bring unnecessary complexity? What would each structure allow fund managers and investors to do that they are unable to do currently in the UK regime? Please address each proposed unauthorised structure separately, and indicate which of the proposed unauthorised structures you consider most important.

We have seen and support the submissions of AIMA, AREF, BPF, INREV and IPF in favour of a flexible range of PIF structures, as useful onshore options for CRE debt funds as well as for other asset classes. We also agree that the LTAF and the PIF could usefully complement each other. The existing UK authorised fund range largely serves the UK investor market, so a new range of non-authorised private fund structures which are straightforwardly tax exempt and/or can benefit from treaty access, and have more flexible regulatory rules are required to compete with comparable vehicles in jurisdictions like Luxembourg and Ireland and attract the international investor market.

In relation to our proposal for a UK Mortgage REIT, we envisage the tax treatment following that for UK REITs generally (on the basis that CRE loans and the payments arising under them count at qualifying assets and income respectively for the purposes of the balance of business test). It would allow the formation of permanent capital (and therefore less cyclically vulnerable) CRE debt investment funds with different access to capital markets for equity and debt as compared to existing (mostly closed-ended, limited life private equity style) structures, providing liquidity for investors through secondary trading on the listed market rather than through redemption rules requiring careful and complex management. The potential benefits in terms of greater CRE debt market information and pricing transparency should also be noted.

31. Would these unauthorised structures support the government's work on facilitating investment in long-term and productive assets, as outlined in Chapter 1?

We believe that providing additional, onshore opportunities for investors to gain exposure to CRE debt (alongside direct investment in CRE and equity and debt investment in infrastructure and other illiquids) could play a critical role in facilitating investment in long-term and productive assets – namely, the commercially owned and operated buildings that make up much of the UK's built environment. Each of the PIF, LTAF and Mortgage REIT proposals would add different new dimensions to the UK funds regime, and should attract new sources of capital and support a range of investment strategies for UK towns and cities, which could in turn support post Covid rebuilding, levelling up and green transition. We refer you to our general comments above.

32. How do you think the government could best achieve consistent branding for UK fund structures which target only professional investors?

In relation to the PIF proposal, we are generally in agreement with the submissions of AIMA, AREF, BPF, INREV and IPF.

In terms of our proposal for the expansion of the UK REIT regime to incorporate Mortgage REITs, we believe there is value in the use of that globally recognised brand (albeit the precise UK rules for Mortgage REITs, like its rules for REITs, may differ from those of other countries – as indeed they should, for example to ensure that the very highly leveraged model seen in certain US residential mortgage REITs is not reproduced in the UK).

33. Do you think that these unauthorised structures should be unregulated collective investment schemes? If you consider any 'light-touch' authorisation necessary or desirable, what do you understand this term to

mean and what form could it take? Why would it be beneficial for investors, and how could it be explained to them in a way that avoids confusion with the regulatory assurances of fully-authorised structures?

We are generally in agreement with the submissions of AIMA, AREF, BPF, INREV and IPF. The position for UK Mortgage REITs should be in line with that of REITs more generally.

34. Do you think these structures should have flexibility on whether they are open-ended or closed-ended? Should they have flexibility on whether they are listed or non-listed? How important is this?

We understand that the majority of private debt funds (such as might in future benefit from the availability of a PIF) are closed-ended and private, unlisted vehicles.

In broad terms, we believe that while a greater level of prescriptiveness may be appropriate for funds intended for retail distribution, the regime for funds aimed exclusively at institutional and professional investors should be flexible, allowing managers and investors to select the approach (including as to whether open or closed ended and listed or non-listed) that best suits the particular fund strategy.

We separately propose the introduction of Mortgage REITs in the UK, providing a listed option for CRE debt alongside CMBS. At this stage, we have not identified ways in which the regime for Mortgage REITs should diverge from that for REITs generally.

35. Do you think these vehicles should or could be implemented as part of existing structures set out in legislation? Please provide details. If not, please explain why not.

No comments.

36. Are there any specific tax treatments that would be either necessary or desirable to support the successful introduction of new unauthorised fund vehicles in the UK? Please provide detail of how and where this is the case.

The key tax requirements would include a (non-mandatory, ideally tax treaty compatible) tax exemption regime, an exemption for stamp duty/SDRT, withholding tax exemptions, addressing concerns about VAT on investment management fees so as to be comparable with a UK investment manager managing a non-UK fund, and simplification of tax administration.

It would be helpful to allow a check-the-box election in relation to tax transparency or opacity for funds with US investors, and consideration could be given to allowing an election to tax certain income and gains if needed for treaty access.

37. Are there any interactions with wider tax policy that the introduction of new unauthorised vehicles would need to navigate, in order to avoid unintended consequences?

The key here is to deliver tax neutrality for investors (i.e. they should be left in no worse a position than had they invested in the assets directly). This includes enabling double tax treaty access directly or indirectly for investors – that should be a focus of bilateral double tax treaty negotiations.

Other proposals

38. Are there other things government should consider as part of this review of the UK funds regime, or proposals for enhancements to the UK funds regime which the government has not included in this call for

input? If so, how important are they and how would you like to see them prioritised in relation to the proposals explored in this call for input?

UK Mortgage REITs

As mentioned above, we believe the UK should adapt its REIT regime to accommodate Mortgage REITs, i.e. REITs that provide loans to commercial property businesses and a steady and predictable income to their shareholders. In summary, UK Mortgage REITs:

- would not give rise to a liquidity mismatch for investors despite the relatively illiquid nature of the underlying investments, because shares could be traded on a stock exchange (as is the case for the UK's existing REITs);
- would be a valuable addition to the limited options currently available for investors to gain exposure specifically to diversified CRE debt, also adding transparency to a market that is generally private and opaque;
- would add to the stability of the CRE debt market because their permanent capital would allow them to manage the maturity profile of their loans – unlike limited life investment structures, they would not need their loans repaid or refinanced at the same time, so could avoid the risk of a period of property market stress at the wrong time in the fund lifecycle.

A UK Mortgage REIT regime would remove the frictional costs of offshore structures, which would be good for UK jobs while also making it easier for UK M-REITs to build the scale required for them to establish themselves in the market.

VAT treatment of management fees

We note that a consultation on the VAT treatment of management fees is planned. We agree with AIMA, BPF and INREV that reform is required to address the current position, which is unfavourable compared to the position in competitor jurisdictions.