Property unit trusts for pension funds and charities

Although property unit trusts are still much smaller collectively than conventional unit trusts, they have grown exceptionally fast since the first trust was formed in March 1966. This note introduces a new series of quarterly statistics for property unit trusts, showing their sales of units and their investment transactions. The series has been compiled by the Bank with the co-operation of the managements concerned, for which the Bank are grateful. The figures are used in the sector financing accounts[1] and also in the estimates of fixed capital formation in the official statistics of national income and expenditure.

The origin of property unit trusts

In recent years life assurance companies and the larger pension funds have devoted an increasing proportion of their accruing funds to direct investment in property. Such investment has offered an assured and growing income and a protection against the erosion of the value of money. It has become increasingly popular since the Finance Act of 1965, which made it much more attractive for tax exempt bodies (such as approved pension funds and charities) or institutions paying preferential rates of tax (for example life assurance funds) to own and manage property themselves than to buy the shares of property companies which would be subject to corporation tax on income and capital gains. The very large insurance companies and funds were able to hold and manage property on their own, but this was uneconomic for many smaller pension funds and charities, because of the special knowledge and skills required. These smaller institutions needed a convenient vehicle for collective investment in property, and found it in the property unit trusts, of which there are now thirteen.

The nature of property unit trusts

Like the conventional unit trusts which are designed for investment in ordinary shares,[2] property unit trusts are trusts in the legal sense, and not companies. Their assets are held in the name of a trustee (commonly a bank) and are managed by a separate committee or company. A beneficial interest in the trust is represented by a unit comprising a proportionate claim on the trust's total net assets.

Because they invest in property other than securities, property unit trusts cannot qualify as 'authorised unit trusts' under the Prevention of Fraud (Investments) Act 1958. This means that the permission of the Board of Trade is required for the distribution of circulars inviting subscriptions, whether at the time the trust is started or later. Such permission will depend on the standing of the sponsors and trustees and be conditional on the restriction of the list of prospective members to pension funds and charities

1 Property unit trusts are included under financial institutions other than banks.
2 Described in the March *Bulletin*, page 62.

approved for exemption (or partial exemption) from tax by the Inland Revenue. Thus circulars may not be sent to individual private investors; nor may the trusts advertise for funds in the Press.[1] Charities which it is intended to approach must have investment capital above a minimum limit. In addition, the trust deed must ensure that the unit holders have ultimate control of the fund (usually by majority representation on the committee of management).

As the subscribers to the trusts are not liable to tax, the trusts, which are outside the scope of corporation tax, can obtain exemption from capital gains tax.[2] Income tax at the standard rate has to be deducted at source from the trusts' distributions, but can be reclaimed by the exempt funds concerned.

The property unit trusts are designed specifically for direct investment in real property. They normally restrict themselves to 'commercial' property (office buildings, shops and factory premises). They have so far invested mainly in existing properties, but have recently begun to undertake new development, either by themselves or with other interests. Their acquisitions are frequently of the 'sale and leaseback' type, where the trust buys a property from the owner-occupier and simultaneously leases it back to him on agreed terms. As nearly all leasing agreements now provide for a periodic review of rentals, the trusts can expect their income to grow over the years. Because there is usually some delay before the funds subscribed to the trusts can be invested in suitable properties, the trusts often have considerable amounts of cash in hand; this is usually placed on deposit with banks or lent at short term. Property unit trusts are permitted to finance investment by long-term borrowing.

Pension funds and charities will usually regard their holdings in property unit trusts as essentially long-term. Nevertheless, provision is needed for the resale by investors of their units on fair terms. This is more difficult for property unit trusts than for conventional trusts whose assets consist of readily marketable stock exchange securities. In consequence, the trust deed normally requires that the investor should give some months' notice of withdrawal. Managements may find the necessary cash from liquid assets, by borrowing on mortgage, or by selling properties; otherwise the units concerned may be offered first to other members of the trust and second to suitable new members.

The statistics

The table which follows shows the total net sales of property units between early 1966 and the end of 1967; current assets and liabilities at that date; and total net purchases of property at cost. Thereafter quarterly net figures are given for sales of units, changes in current assets and liabilities, and purchases of property at cost. The statistics cover all thirteen property unit trusts for pension funds and charities.

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1 They may, however, advertise in their own names for suitable investment properties.

2 'Partly approved' superannuation schemes are only partially exempt funds, and property unit trusts formed to cater for them are accordingly only partially exempt.

Property unit trusts: sales of units and net transactions

£ millions

	Mar. 1966 to Dec. 1967	1968 1st qtr.	1968 2nd qtr.	1968 3rd qtr.	1968 4th qtr.	1968 Year	1969 1st qtr.	1969 2nd qtr.	Mar. 1966 to June 1969
Net sales of units to:									
Pension funds	28·5	11·2	12·6	14·7	9·6	48·2	10·5	12·8	100·2
Charities	1·0	0·3	0·3	0·8	0·2	1·6	1·3	0·2	4·0
Total	**29·5**	**11·5**	**13·0**	**15·5**	**9·8**	**49·8**	**11·8**	**13·1**	**104·2**
Net transactions:[a]									
Cash and balances with U.K. banks	12·8	2·8	5·6	6·9	− 7·1	8·2	1·9	− 2·3	20·6
Other current assets	0·3	0·3	− 0·2	0·1	0·5	0·7	0·5	0·4	1·9
Current liabilities	− 0·6	− 0·1	—	− 0·1	− 0·1	− 0·3	− 0·1	− 0·3	− 1·2
Property	16·6	8·0	7·8	8·6	16·3	40·8	10·0	15·1	82·3
Other assets	—	—	—	—	—	—	—	—	—
Total	**29·1**	**11·0**	**13·2**	**15·6**	**9·7**	**49·3**	**12·4**	**12·8**	**103·6**

a Positive figures indicate a net rise in assets or a fall in liabilities. Some transactions are financed by longer-term borrowing, and not by sales of units. Investment in property is shown at cost.

Future growth

From their inception in March 1966 until mid-1969, the property unit trusts clearly expanded rapidly. There seem now to be some possible restraints on their future expansion. With new office building in the London area still restricted by legislation, the supply of suitable investment properties there is limited and subject to competitive demand from insurance companies and the large pension funds. Also the trusts are at present deprived of some potential support from charities and local authority pension funds, most of which at present lack the necessary powers to invest in property unit trusts.[1] Nevertheless, it seems likely that the trusts will continue to attract a growing volume of funds. The series of statistics introduced here will therefore be continued in the statistical annex to future *Bulletins*.

1 Most charities and local authority pension funds are restricted to investments permitted by the Trustee Investments Act 1961. Property unit trust units do not fall wihin the provisions of this Act. Indirect investment in property is, however, open to local authorities through the Local Authorities Mutual Investment Trust.