

Commercial Property Guide

A guide for pension scheme investors.

Capability. On every level.

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Why we are different.

We're self invested pension specialists.

We appreciate that purchasing a property through your pension scheme doesn't happen often and that every purchase is different. It's why we'll use our expertise to work with you every step of the way.

With 40 years' of experience, we're experts at dealing in all aspects of pension property transactions.

Working within the framework of pension legislation, you can finance your commercial property purchase either solely through your pension scheme, by borrowing funds, or with the help of other parties – connected or unconnected – to pool funds and purchase commercial property collectively or participate in property syndicates, if required.

It's about taking a commonsense approach and using what we know to make your pension fund work to your best advantage. From feasibility discussions supplemented with answers to our property questionnaire, our aim is to facilitate the investment without putting unnecessary barriers in the way.

We offer the following market-leading features:

- › joint transactions between your pension scheme and other pension schemes, individuals and companies
 - › ability to phase the property purchase
 - › flexibility to choose your own qualified professionals - solicitor, valuer and lender
 - › all UK commercial property considered
 - › freedom for clients to manage their own commercial property
 - › VAT registration, where applicable
-

Please note: The term 'pension scheme' is used throughout this brochure to cover both SIPP's (Self Invested Personal Pensions) and SSAS's (Small Self Administered Schemes) unless specifically stated otherwise. The term 'property' can also mean land.



Capability on
every level.

Dentons
administer
over 3700
commercial
properties.

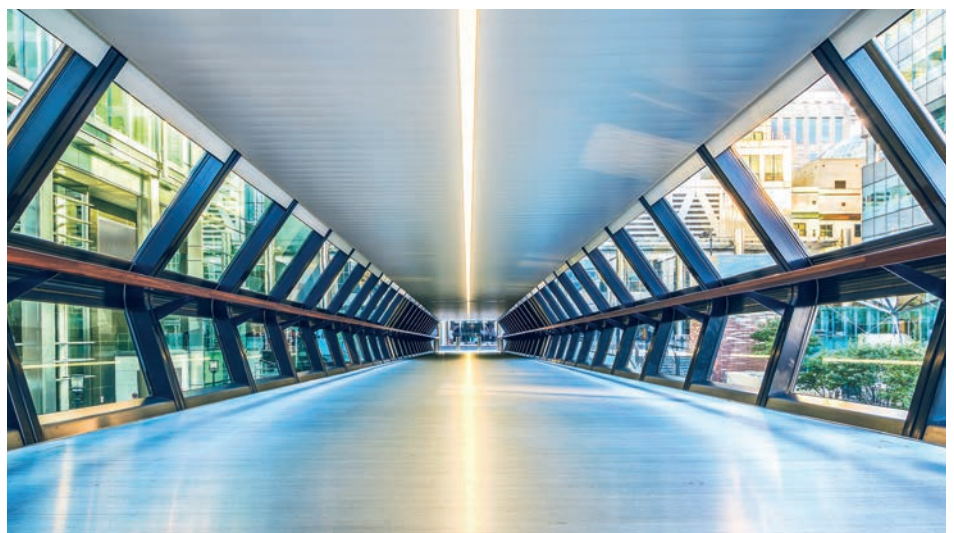
The benefits.

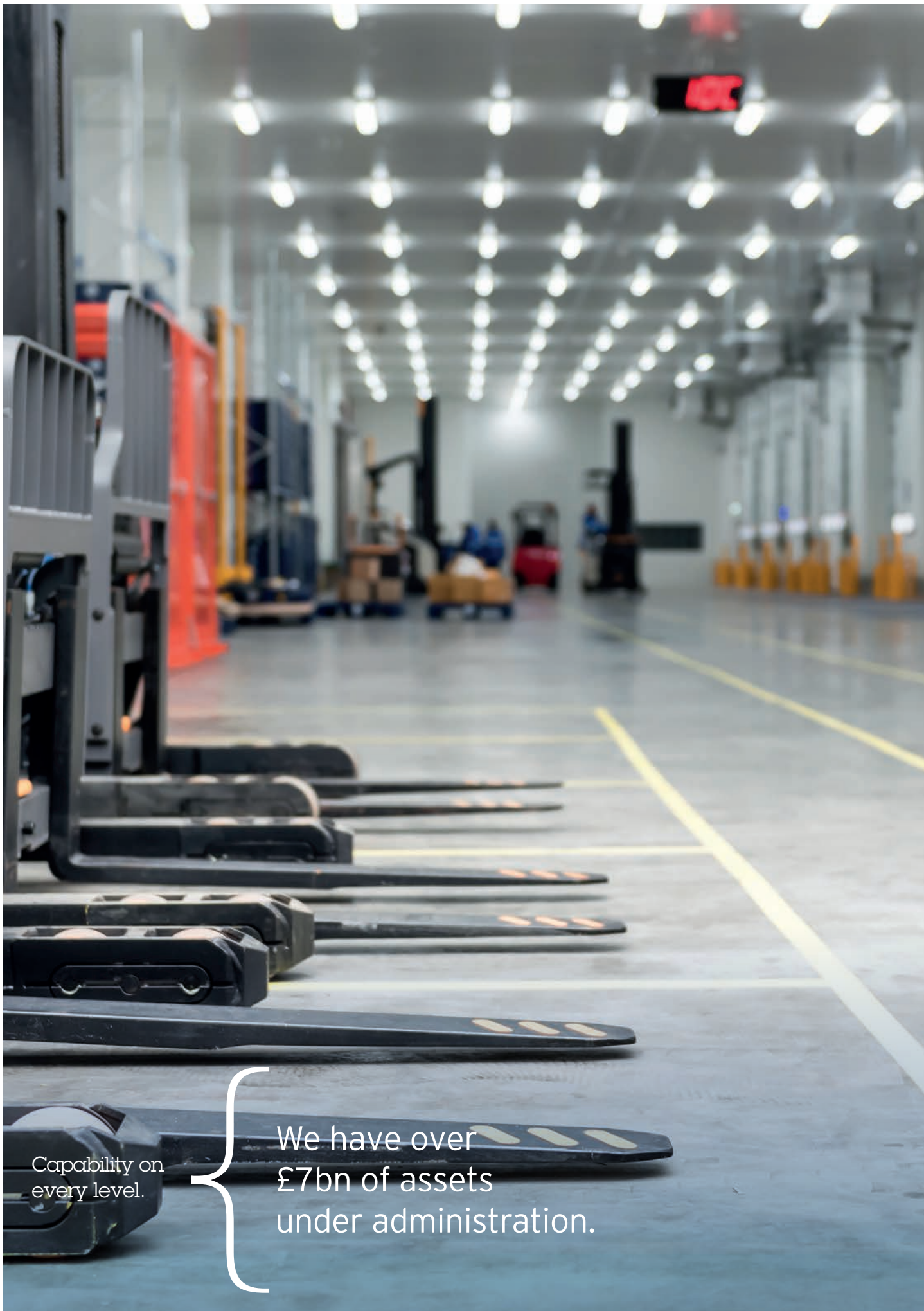
There are many advantages to using a pension scheme to purchase commercial property. However, you should always remember that the prime purpose of any pension scheme is to provide for your future financial needs in retirement and that any investment of the scheme should be made with this in mind.

Key advantages

- › Tax relief on contributions to the pension scheme which can be used to purchase the property
- › Any gain on the property value is free from capital gains tax
- › Open market rent is paid to the pension scheme
- › All rent from tenants is received gross and is free from income tax
- › Rental income payable by the tenants can be treated by them as a business expense for tax purposes and can reduce the income and corporation tax liability of the tenant
- › Property is outside the member's estate for inheritance tax
- › Capital released back to the business when property is purchased from it to help with cash flow
- › Opportunity to borrow funds towards the purchase and development of the property
- › Once the mortgage is paid off, ongoing rent and contributions can continue to build the retirement fund: these can be used for other investments and/or to pay benefits on retirement
- › The property may not need to be sold as continuing income could service pension payments
- › Should the business fail then the property will be protected from creditors.

Aside from the advantages mentioned above, you should always take other factors into account when holding commercial property within your pension scheme. Please see the section on **Property purchase considerations** on page 9.





Capability on every level.

We have over £7bn of assets under administration.

The rules.

HM Revenue & Customs (HMRC) impose tax penalties if certain types of property are acquired.

Acceptable property

Acceptable properties must be commercial, located in the UK and can be either freehold (outright ownership of the property) or leasehold (holding property for a specific number of years in return for paying a rent to the landlord).

Examples of acceptable properties include:

- › offices
- › industrial/business units and warehouses
- › shops
- › agricultural land
- › land for commercial development
- › garages
- › nursing homes
- › public houses
- › marine berths
- › hotels.

Acceptance of all commercial property is subject to satisfactory due diligence.

Non-permanent fixtures and fittings must be excluded from the property purchase otherwise they can give rise to a tax charge.

Property development

Commercial property can be developed or refurbished as part of a pension scheme provided no residential element is added. Similarly, land can be purchased and used to develop commercial premises.

We will need to see written quotations and details of the proposals so we can authorise the improvements or development prior to any work taking place.

If your or a connected persons' business is to undertake the property development/refurbishment, we will require quotes from that business along with quotes from at least two other unconnected businesses for comparison purposes.

Auction purchases

We will consider the purchase of a property at auction through your pension scheme. However, we need adequate time before the auction date to ensure the suitability of the property and confirm that sufficient funds are in place. If you have transferred funds to your pension scheme from another pension scheme, to facilitate the purchase of a property at auction, there is a mandatory 30-day transfer period during which these funds are not permitted to be used for an illiquid investment such as property.

Unacceptable property

Residential property is not permitted other than in a very few exceptional circumstances. Commercial property with a residential element may only be accepted if it can be demonstrated that the residential element is an integral part of the property, such as a caretaker's flat or a flat occupied by an employee as part of their terms of employment.

The employee cannot be connected to any pension scheme member and any rent paid will need to be on a commercial basis.

Other unacceptable properties include:

- › holiday lets
- › timeshares
- › beach huts
- › commercial freeholds where there is also a reversionary interest in a residential leasehold within the property
- › student flats unless they are part of a hall of residence directly connected to an educational establishment.

Unacceptable purchases

If a pension scheme becomes involved in the frequent purchase and/or development and selling of properties, HMRC may deem such transactions as 'trading'. Whilst both capital and income investment gains are normally tax exempt, if trading applies any associated income and capital gains would then be taxed accordingly.

Please note: Dentons will review all property purchases on a case-by-case basis. We reserve the right to refuse purchases and/or any proposed developments of property if we believe that the purchase or development may give rise to a tax charge or there were unacceptable levels of potential risk such as contamination.



The structure.

We use our in-depth knowledge and expertise to bring independence and security to your pension scheme.

The commercial property will be held under trust for your pension scheme and any other parties, if applicable.

Pension structure

If your chosen investment vehicle is a SIPP, this is established as an individual sub-trust, unique to you as the Member and co-trustee. In order to give independence and security to your pension scheme, our trustee company - which is a non-trading company - will act as the independent co-trustee.

For a SSAS, this is established as an individual stand alone trust by the sponsoring employer for the benefit of the scheme members. All members of the scheme should be trustees together with our professional trustee company.

The property will normally be registered in the name(s) of the Member trustee(s), albeit our trustee company will require a restriction on the title in order to approve any subsequent changes in ownership.

Joint ownership

Our pension schemes can jointly acquire property with other parties. This does not have to be in equal proportions. Potential parties include:

- › other Dentons' pension schemes
- › pension schemes from another provider
- › connected or unconnected individuals or companies.

Where joint purchases occur, a separate bank account is usually set up into which rental payments are made and if borrowing is required, mortgage payments deducted. Any surplus funds are then distributed in the appropriate proportions to the joint property owners. There should be sufficient funds in each individual pension scheme fund to meet any liabilities. If not, you - or the other parties - may have to provide further funds. Those parties that are pension schemes would first need members or employers to make contributions to the scheme (which would be subject to contribution limits).

In addition the property should be purchased using a declaration of trust.

The trustee(s) of the declaration of trust, as the legal owners, will act as nominee(s) holding the property for the benefit of the participants in the relevant proportions.

Property purchase considerations.

Costs

You need to take into account all likely costs when considering property as an investment. It will be necessary to ensure sufficient funds will be in place to complete the transaction because the pension scheme is responsible for meeting these costs, or its share of the costs in the case of a joint property purchase.

In addition to the property purchase price, consideration should be given to the following:

- › solicitor fees
- › valuation fees
- › land registry fees
- › Stamp Duty Land Tax (or Land and Buildings Transaction Tax for properties in Scotland), depending on the purchase price of the property *
- › VAT, if applicable
- › lender's fees, if applicable
- › our charges for acquiring the property purchase through your pension scheme, including a desktop environmental risk assessment
- › other costs may include a further environmental risk survey, EPC certificate and an asbestos survey.

***Please note:** This tax is payable on both the purchase price and any associated VAT liability.

All charges in respect of the property investment should be paid from the pension scheme as they are a direct cost of the pension scheme investment strategy.

Financing

As stated previously, you'll need to ensure that sufficient funds are available in the pension scheme to cover all costs. Therefore, a suitable funding plan should be set up before a property can be purchased. Please see the section on **Financing the purchase** on page 12.

Illiquid investment

Commercial property is an illiquid investment and disposal of it may take an extended period of time. You should take this into account when considering the investment in light of the need for liquid assets to pay benefits as and when they fall due.

At this stage the property will need to be valued which will incur a cost to the pension scheme.

Whilst commercial property can be an excellent long term asset, you should be mindful of possible exit strategies.

Taking income

If you're taking pension income, the property can continue to be an investment. However, if your fund is to be used to purchase an annuity, all of the assets held within the pension scheme, including any property, may need to be sold.

On death

On death, the property will be treated in the same way as any other investments held within the pension scheme. Providing enough cash is available to settle any tax charges, it may be possible to transfer ownership to a beneficiary as an in-specie benefit and avoid the need to sell the property.



We can provide guidance to you and your solicitor on all aspects of purchasing a property through our pension schemes.

Timescales

Where borrowing is required to finance a property transaction, contracts will not be exchanged until the relevant financial arrangements are in place. The time taken to complete the property purchase within a pension scheme will, therefore, vary depending on the complexity of the arrangement. You should allow a minimum of 6-8 weeks.

In summary, you need to be realistic about the timescales involved because unexpected issues could have a major impact on the ability to meet deadlines.

Investment security

Many people consider 'bricks and mortar' to be a secure investment - and one that is generally accepted to be uncorrelated with the rises and falls of the equity market - but recent history suggests that property values can be as susceptible to fluctuations as other asset classes.

Environmental and legal issues

When we receive initial details about your property, we'll commission an initial desktop environmental survey on behalf of the trustees. These reports are for the benefit of the trustees, rather than for a lender. As a result, the solicitor may also need to carry out an environmental survey on behalf of the lender.

This environmental report is crucial. If land is designated as contaminated, and the polluter cannot be found, the 'owner or occupier' will be deemed the appropriate person to bear the cost of cleaning up the site or adjacent sites if third party damage is created.

For commercial properties, especially buildings constructed before 2000, there may be a risk from asbestos products. This needs to be identified and addressed prior to purchase. For this reason the asbestos register and management plan needs to be available.

Failure to comply with the Asbestos Regulations may result in the Health and Safety Executive taking action against the 'dutyholder'. This is normally the person responsible for the maintenance and repair of the premises under the terms of the lease, which is usually the tenant, but could also include the trustees, as owners. There may also be a need to commission an Asbestos Survey.

Energy Performance Certificate (EPC)

An EPC is needed when a property is built, sold or rented and gives a property an energy efficiency rating from A (most efficient) to G (least efficient). Legislative changes that came into effect from April 2018 mean that commercial premises that do not reach minimum energy standards of an 'E' rating will be unable to be let and steps will therefore need to be taken to improve their energy efficiency.

Aborted transactions

If, for any reason, a proposed property purchase does not complete, fees will still apply for all work completed to date.

Tax

Please see the **Tax considerations** section on page 14.

Connected persons

Your pension scheme can purchase property from you, a person connected with you or any other party. However, any purchase from or disposal (including a lease) to a connected person must be evidenced as being on a commercial basis. It needs to be on 'arm's length terms' in accordance with an independent professional property valuation by a recognised Member or Fellow of the Royal Institution of Chartered Surveyors (MRICS/FRICS) who is a Registered Valuer and will therefore carry out the valuation in accordance with RICS 'Red Book' standards.

A 'connected person' includes the following:

- › you (as the Member), your spouse or civil partner
- › a relative of either you or your spouse or civil partner
- › the spouse or civil partner of a relative of you or your spouse or civil partner
- › a person who is in partnership with you or your spouse or civil partner or relative
- › a company which is controlled by you and/or persons connected with you.

Please note: 'Relative' in this context means brother, sister, ancestor or lineal descendant. For HMRC reporting purposes 'connected person' also includes close companies of which you - or a person connected with you - are a director.

Rental payments between connected parties must be maintained on an 'arm's length' commercial basis or tax charges will apply. If the tenant is a connected party and is in financial difficulty, the rental liability will still continue.



Capability on every level.

Over 40 years' commercial property expertise.

Financing the purchase.

There are several ways to finance your commercial property transaction. These can include contributions to your pension scheme (subject to certain limits), transfers from other schemes, borrowing or joining with other parties.

Transfers and contributions

To fund a property purchase, transfers can be accepted from other registered pension schemes and/or contributions can be made. For full details of the limits on contributions, please refer to the Dentons SIPP or SSAS guides.

Borrowing

Your pension scheme can borrow to help with the acquisition of investments - such as commercial property - by way of a commercial mortgage. Any mortgage offer must limit the liability of the trustees to the security given, or, if necessary, the assets of the pension scheme.

The maximum level of borrowing allowed is 50% of the net asset value of the pension scheme on the day immediately prior to the borrowing and this can only be secured against the purchased property or other assets of the pension scheme.

Any existing borrowing must be accounted for within the 50% fund limit and borrowing cannot be extended to meet VAT if it applies.

We will consider any reputable commercial lender for the borrowing and can provide guidance to the lender on the legal requirements of the mortgage loan.

Borrowing from a connected party is also permitted if it can be evidenced that borrowing on identical terms could have been secured from a third party lender.

The mortgage loan is usually based on capital plus interest. However, an interest only loan may be acceptable in certain circumstances and subject to the lender's terms.

Please note: The ability to borrow does not cease once benefits have come into payment from the pension scheme.

Any mortgage offer must limit the liability of the trustees to the assets of the pension scheme.

Transfer of property in-specie

An in-specie transfer is the transfer of the legal ownership of an acceptable property held in another of your pension schemes to the trustees of your Dentons' pension scheme as part of the transfer of your accrued benefits.

Such a transfer is not normally subject to Stamp Duty Land Tax, Land and Buildings Transaction Tax (for properties in Scotland) or VAT (where the property has been opted to tax) provided the transfer qualifies as a **Transfer of a Going Concern** (please see page 14).

Joining with other parties

It is also possible for one pension scheme to buy part, or all, of another's share of the property. Unequal borrowing for joint property purchases is permitted.

Liquidity

Due to the illiquid nature of commercial property investment, post-acquisition we will require further funds to be held in the pension scheme, either as cash or other liquid/tradable assets, in the event that funds are required to meet liabilities. This further funds requirement will vary based on the size, nature and circumstances of the property in question. Please speak to your Dentons representative for further details.

Appointing specialists.

We like to be as flexible as possible. That's why you're free to use your own valuer, solicitor or mortgage lender – provided they are regulated or hold appropriate professional qualifications. We can also introduce you to other professional firms who are experts in this area.

Solicitor

Your solicitor will be acting on behalf of the trustees and will need to keep us informed of progress. It will be the solicitor's responsibility to undertake all of the usual searches and confirm that there are no adverse factors - including environmental issues - which need to be brought to the purchaser's attention.

Registration of the property at the Land Registry should reflect that the property is held in trust and not held personally with a beneficial interest. This means that, once acquired, the property will normally be registered in the names of the Member trustee(s).

If any borrowing is involved, we would expect the solicitor to ensure that the interests of the trustees are protected. Any mortgage offer must limit the liability of the trustees to the security given, or, if necessary, the assets of the pension scheme and in no circumstances should any liability of our trustee company be personal.

If a new lease is required, it must be prepared by your solicitor.

Surveyor

Where required, you should appoint an independent professional surveyor who is MRICS and FRICS qualified and is a Registered Valuer, to carry out a survey and valuation of the property on behalf of the pension scheme trustees.

We would expect completion to have taken place within three months of the date of the surveyor's valuation otherwise an update to the valuation will be required.

If borrowing is involved, the proposed lender may be prepared to accept your surveyor's report and valuation. However, in some cases, they may insist on a report from their own approved surveyor.

We will require evidence of the value of the property which can be a letter from the surveyor. A full survey report is not normally required by us.

Where the property is to be leased to a tenant who is connected with you, the surveyor must also confirm the market rent that should be charged.

Lender

The trustees have power to grant a charge over assets owned by them. Any borrowing needs to be granted to the trustees. Under no circumstances can cross guarantees or cross subsidy be given.

We will need to see any documentation, and approve any borrowing, prior to exchange of contracts to ensure that it meets with both our own and HMRC requirements.

Where more than one pension scheme and/or other parties join together to purchase a property, a Declaration of Trust will be put in place, which will confirm each pension scheme's/party's beneficial interest in the property. The trustees of that Declaration of Trust will be the registered owners of the property.

If a pension scheme takes out secured borrowing to assist with such a joint purchase, the loan agreement will be with the pension scheme trustees (and there will need to be a separate loan for each pension scheme) but the legal charge will need to be granted by the trustees of the Declaration of Trust, as the registered owners. We will provide a draft Declaration of Trust for the appointed solicitor's consideration.



Tax considerations.

Pension schemes provide a number of tax advantages but consideration must be given in advance if VAT applies to a property purchase.

VAT implications

It's important to understand the implications of VAT on the property and the pension scheme from outset. A property is either 'subject to VAT' when built - many new buildings are usually automatically opted for VAT - or can be 'elected for VAT', such as for development work.

If you decide to register the pension scheme trustees for VAT, this will enable the reclaiming of any VAT on the purchase price. If so, the registration needs to take place before the property is purchased. Similarly, if your pension scheme is developing or refurbishing a property, VAT on the costs incurred may also be reclaimed.

To do so, you will have to opt to tax, which means VAT will be chargeable on rent. Quarterly VAT returns will also be required.

All invoices and rental costs should be addressed to the trustees of the pension scheme. VAT will also be chargeable on the sale price when the property is sold.

Please note: Getting the VAT status wrong can have major tax implications. You should seek advice from a VAT specialist.

Transfer of a Going Concern

In certain circumstances, where both the vendor and pension scheme have registered for VAT and opted to tax the property, VAT does not have to be charged on the sale price provided the conditions of a 'Transfer of a Going Concern' (TOGC) are met. To qualify, there must already be a lease in place and the lease continues in force after the transfer of the property to the pension scheme - the business of letting the property is transferred as a going concern.

Rental income

All rent from tenants is received gross and is free from income tax. Rental income payable by the tenants can be treated by them as a business expense for tax purposes and can reduce the income and corporation tax liability of the tenant.

Inheritance tax

Property held within the pension scheme is outside the member's estate for inheritance tax.

Disposal of property

Under current legislation, there will be no capital gains tax to pay on disposal of the property by the pension scheme.

The process.

Client finds a property and completes Dentons Commercial Property Questionnaire

If the property is accepted, finance for the purchase of the property is arranged

Confirm property valuation by a MRICS/FRICS surveyor who is a Registered Valuer if the property is purchased from a connected party

Rental valuation assessment (if required)

Client selects solicitor

Client Actions

Pension scheme established (where applicable) and funding to the pension scheme arranged e.g. transfers, contributions

Joint Action

Dentons Actions

Dentons considers and accepts (or rejects) the property

Dentons carries out a desktop environmental search

In the case of a joint property purchase, Dentons sends out a copy of the Declaration of Trust to record the beneficial ownership between the parties

Dentons writes to the appointed solicitor and gives instructions

There are a number of stages involved in property acquisition, with various tasks and responsibilities for each of the parties involved. We'll be your guide, telling you who needs to do what – and when – so you feel in control at all times.

Solicitor carries out various searches and prepares:

Report on title, Land Registry document, a lease (if applicable) and any other relevant documents.

Property acquisition completed: client must have insurance in place at completion or at exchange of the property and arranges property management

Rental valuation arranged (if required)

The time taken to complete a property purchase will depend on the complexity of the arrangement but a minimum of 6-8 weeks should be allowed.

Dentons receives finance documents for borrowing from the lender and approves

Dentons receives completed documents from the solicitor and requests a completion statement

Dentons sends completion monies and necessary contractual signed documents to the solicitor

Managing property.

Once you've purchased your property it's essential that it is properly managed. We give you the freedom to choose the solution that suits you best.

Your obligations

We don't insist upon the appointment of a property manager - provided it can be demonstrated that the necessary property management functions are being undertaken.

These tasks include:

- › adequately insuring the property
- › ensuring leases are prepared by your solicitor
- › invoicing rents and securing payment in accordance with the lease
- › undertaking rent reviews
- › completing VAT returns
- › meeting all legal duties such as environmental and asbestos management requirements
- › ensuring the tenant observes the covenants in the lease (eg payment of rates, taxes and insurance premiums)
- › monitoring the condition of the property and ensuring the tenant arranges for any necessary repairs or maintenance to be carried out to an acceptable standard
- › maintaining proper records and books of accounts, which should be available for inspection.

We do, however, have a fiduciary responsibility to monitor rental payments and, should they fall into arrears, to take legal action to recover what is owed.

The property should also be re-valued periodically to ensure its current value is recorded correctly in the pension scheme valuations or accounts. We don't insist upon formal valuations other than on important dates - including commencement of benefits and periodic benefit reviews.

Insurance

As owners of the property, the trustees have a responsibility to ensure adequate insurance is in place - including public liability insurance if applicable - and we will request copies of all relevant certificates.

The property must also comply with current disability discrimination laws.

Dentons will arrange for the property to be insured under a block policy arrangement unless alternative arrangements are required or the property is a leasehold and the freeholder arranges the insurance.

Leases

Your pension scheme can lease a commercial property to anyone. This includes your business, your company, a partnership in which you are a partner or to a person with whom you are connected, provided it is for business purposes.

Where the lease is to you, or a person connected with you, it must be on 'arm's length commercial terms'. It would be expected that a tenant would enter into a full 'insuring and repairing lease' with regular rent reviews and the solicitor must once again act on behalf of the pension scheme trustees.

Leasing to unconnected third parties is acceptable and, in such cases, no evidence for setting rental terms is normally required.

A solicitor must draft all leases.

Rental payments

Where the property is leased to a connected person, the pension scheme trustees will commission an independent professional surveyor who is MRICS or FRICS qualified and is a Registered Valuer, to determine the open market rent payable based on the proposed lease terms.

If improvements to an existing commercial property, or those purchased with the intention of making improvements, are carried out, outside of the normal repairing and maintenance terms of the lease, then the rent may need to be reviewed. This may involve a variation to the existing lease and an updated rental valuation.

Where non-payment of rent or another debt is created, which is not repaid on 'arm's length terms', the member or tenant may be liable to tax charges. This debt may be seen as a 'loan' and become an 'unauthorised payment' under pension tax rules. In addition, the pension scheme may be subject to a Scheme Sanction Charge.

Property case study.

Mr & Mrs Williams run a successful florist as a partnership from a busy rented high street location.

They have outgrown the existing premises and are now considering purchasing their own business premises. They have been advised that they can use their pension funds to achieve this.

The facts

- › Mr & Mrs Williams each have £100,000 in their pension funds
- › The proposed shop is valued at £240,000 which can be purchased using their personal pension funds
- › They will each need to establish a Dentons SIPP
- › Their SIPPs can each borrow up to an additional £50,000 as this is within borrowing limits. This can be used to meet the purchase price and other associated property purchase costs such as solicitor and surveyor costs, Stamp Duty Land Tax (SDLT) and VAT, if applicable.

The process

- › Mr & Mrs Williams complete Dentons Commercial Property Questionnaire
- › Dentons checks the details to ensure the property is acceptable and there are sufficient funds to cover the property purchase and associated expenses
- › Mr & Mrs Williams confirm the purchase price the SIPP will have to pay
- › They each establish a Dentons SIPP and arrange for the funds from their personal pensions to be transferred
- › Dentons needs to be informed of the solicitors they wish to use
- › Mr & Mrs Williams arrange a commercial mortgage for their SIPPs through their bank which will help to fund their property purchase
- › Once the 30-day mandatory transfer cancellation period has expired, the funds from the SIPP, along with the agreed mortgage loan, can be used to complete the property purchase

- › Mr & Mrs Williams arrange a valuation with a surveyor to provide evidence of the rental income that should be paid by their company into their SIPPs. The surveyor must be MRICS or FRICS qualified who is a Registered Valuer.
- › The solicitor draws up the lease for the rental of the florist shop to the partnership
- › The SIPPs then pay for the property and the solicitor's fee is paid by the SIPPs.

The result

- › Once in the property Mr & Mrs Williams pay the rental income to their SIPPs which is applied to each member's cash account on a 50:50 basis and is used to pay off their respective mortgages.





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The details in this guide are based on Dentons Pension Management Limited's interpretation of the law and HMRC practice as at the date of publication. We will only be able to comment on the acceptability of the property as an investment by the pension scheme but not on its potential as an investment.

These notes are prepared as a guide only. If further information is required relating to a specific property purchase please contact one of our Pension Consultants.

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