Vive le prix discount

It sounds a bit risqué but bare ownership is not particularly risky. The French scheme could appeal to cash-rich property investors prepared for the long haul, as **Faith Glasgow** reveals

Most UK investors interested in French property investment opportunities are steered by energetic marketing towards the leaseback schemes operating in many tourist resort developments.

Leaseback is promoted as a hassle-free arrangement, featuring purchase discounts, guaranteed rental income, no management or maintenance obligations on the owner's part (that's all taken care of by the management company to whom it is leased for holiday letting), and the option of several weeks' personal use of the property each year (see box, opposite).

But another alternative is now beckoning from across the English Channel to British investors who have plenty of cash and are looking for a secure, very long-term home for it. It's known, intriguingly, as bare ownership – nue-propriété –but although the concept has been part of the French property landscape for more than 200 years, it has not so far been promoted abroad to foreign buyers.

The idea of bare ownership is distinctly less raunchy than the name implies, as everyone involved keeps their clothes on in the usual way. However, for investors with €100,000-plus available to tie up in bricks and mortar for 15 to 17 years, who are not interested in the use of the property but purely in capital uplift during that time, it could be quite a titillating proposition.

> "The discount is equivalent to rent that the owner would have collected"
>
> Francois Marchand

Schemes tend to be found in thriving cities such as Paris, where business accomodation is at a premium

The concept stems from the long-established legal distinction between 'bare' ownership of the property itself, and the 'usufruct' or right to use and benefit from it. It works like this. In certain French towns or cities, developers seeking planning permission for a new scheme may have to supply a number of units in the development for the council's use for a fixed term – typically 15 years – as part of the deal.

The council will use these apartments as accommodation for top-end tenants: senior public sector staff or company managers on secondment to the locality, for instance. During the lease period, all maintenance and any property taxes or charges connected with the properties are entirely the council's responsibility.

But the developer needs to find buyers for these properties. For the coming 15 years they will be effectively uninhabitable and unlettable as far as any owner is concerned – so they're no good for owner-occupiers or ordinary landlords. Instead, the developer has to target long-term investors prepared to accept a superior rate of capital growth in return for the sacrificed usage and potential rental income.

Bare discount

The apartments are therefore offered for sale at a discount of 40-50 per cent to the market price. Francois Marchand of Erna Low Property – which is now marketing the concept of bare ownership in the UK – explains that this discount amounts to 'the equivalent of all updated rents, net of costs, taxes and charges, that the owner would have collected over the lease period if they had invested in full ownership.'

Having made their purchase, the 'bare' owners then simply sit back, pour themselves a celebratory absinthe and forget about their investment for the next 15 years. At the end of the lease, the council is obliged to renovate the apartment completely before handing it back to them with full rights of usage.

Once the bare owners finally take full possession of their apartment they have various options. One is to continue to rent it out to the council or other tenants at a market rent; a second is to retain it for their own use as a permanent or holiday base; or they could of course sell it straight away and realise the capital gains.

How might the investment work out financially if they choose this third option and sell when the lease expires? Clearly, it depends entirely upon the strength of the local property market, which is why these schemes tend to be found in thriving French regional cities – Cannes, Nice, Lyon, Toulouse, Paris – where high-quality business accommodation to rent or buy is at a premium. (Paris apartments, for instance, have seen capital growth of around 30 per cent over the past five difficult years, while prices in Nice have risen by around 25 per cent.)

However, working on a fairly conservative estimate of capital appreciation averaging 3 per cent a year over 15 years, Marchand says it's realistic to expect a total return of 160 per cent on the initial investment.

He explains: 'If a property was for sale at €200,000, you would get a 40 per cent discount for bare ownership, so you'd pay €120,000. During the next 15 years you would have no outgoings to pay on it. Assuming annual capital growth of 3 per cent, you'd be able to sell it after 15 years for €311,590 – a profit of €191,590, amounting to a 160 per cent return.'

This is an attractive proposition for French investors, who will have no capital gains tax liability after 15 years of ownership. Better still, bare ownership of a property is not liable to French wealth tax (ISF), which currently affects French taxpayers with more than €1.3 million of assets.

Regional capitals, such as Cannes and Nice, are a good source of bare ownership properties

But as Martin Rimmer, tax manager at expatriate tax specialists the Fry Group, explains, the double taxation agreement between the UK and France means that British taxpayers are likely to be liable for UK capital gains tax at 18 or 28 per cent if they sell the property.

> Married couples should hold the investments in joint names
>
> Martin Rimmer

On the workings above, that could amount to between €35,000 and €54,000 (£31,000 to £47,500 or so at £1=€1.13), though that's before taking into account the annual capital gains tax (CGT) allowance, currently £10,600. Rimmer therefore recommends married couples hold the investment in joint names where possible, to make use of both partners' allowances.

He also suggests that one way to reduce a potential UK CGT liability is for owners to occupy the property for a while before selling. 'If you can occupy the property as your main residence for a while, you'll start to accrue CGT relief on at least the past three years,' he adds. Typically, three to six months is sufficient, but you do have to make it clear this is your main home. It may be easier just to keep the apartment in the family, or accept the tax hit.

What are the risks? Because your property is leased to the care of a public sector body and no income flow is involved, the likelihood of problems is small. Moreover, the council is obliged to return the property in 'as new' condition, so any damage should be made good.

If you do need to access your cash in less than 15 years , you're free to sell, though the asking price will be based only on bare ownership and therefore will reflect capital appreciation based on the original price paid, rather than the current market value.

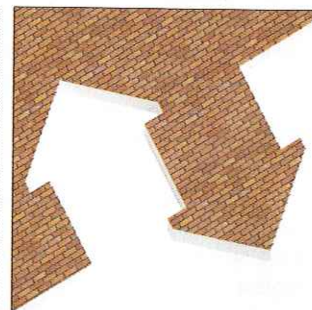
The main problem, according to Marchand, is that units offered for bare ownership are few and go very quickly, usually to French buyers. 'We can put a 48-hour option on an apartment when it becomes available, and then clients can fly over and have a look at it,' he explains.

Currently his list includes around 50 units, priced at market value from €156,000 to €580,000 (so from €96,000 to €348,000 with the bare ownership discount). Around two thirds have a discounted price of €200,000 or under. Clearly, bare ownership won't suit everyone, but for cash-rich investors with a long-term perspective it could be well worth considering.

Leaseback and bare ownership compared

There are clear comparisons, and major differences, between the unfamiliar concept (to British investors) of bare ownership and the better-known idea of leaseback schemes.

Under leaseback arrangements, investors buy apartments in tourist areas that are then leased to a management company for short-term holiday lets. Leaseback, like bare ownership, enables investors to buy brand new apartments at a discount to market value – in the case of leaseback, through the refund of VAT at 19.6 per cent. Similarly, both schemes involve the properties being leased to a third party who deals with all the maintenance and letting for a set period – a minimum of nine years for leasehold.



But there they diverge. Bare ownership involves neither personal use of the property nor rental income during the lease period: it's an investment based on pure capital appreciation. In contrast, leaseback schemes involve the option of a certain number of weeks' use by the owner each year, plus the payment of a guaranteed annual rental return.

This can be used by less cash-rich investors to cover mortgage interest costs, enabling the investment to pay for itself and possibly produce some income on top.

In bare ownership, because there's no income to offset against mortgage interest payments, it makes sense only for cash buyers and French taxpayers (the latter are able to offset mortgage interest against their overall taxable income).

Finally, leaseback is arguably somewhat less secure as an investment, mainly because its success depends on the strength of the management company, but also because the schemes are built in tourist locations, where property values may be more volatile, rather than in major cities with strong local economies.