

# Real Estate Gazette

FOCUS ON: **FOREIGN INVESTMENTS**

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# A note from the Editor



**Olaf Schmidt**  
Co-Chair of the Global Cross-  
Practice Real Estate Sector

A very warm welcome to all our readers to DLA Piper's first Real Estate Gazette of the year. In this issue, we focus on foreign investment.

There are many rewards to be had from investing in real estate overseas, including the opportunity to diversify and the potential for stable and safe returns, among others. However, in addition to such advantages, prudent investors should also be aware of the pitfalls, including unfamiliar tax regimes and a completely alien legal framework governing the purchasing process.

In our Australian article ([page 6](#)), the authors describe the country's foreign investment approval scheme, which regulates foreign persons wanting to acquire an interest in certain Australian land and businesses. They note that failure to comply with the regime can result in harsh financial penalties and even criminal prosecution. Brazil, on the other hand, imposes few legal restrictions on foreign investors generally but the authors of our Brazilian article ([page 10](#)) highlight particular restrictions on the acquisition and lease of farmland by foreigners. Our Polish article makes the point

that its legal system contains some unique features, such as perpetual usufruct, which any foreign investor would need to consider ([page 22](#)), while our UK article focuses on the tax implications for non-UK resident investors in UK property ([page 32](#)). However, it is not all doom and gloom. Many of the articles stress the opportunities available for foreign investors, citing, for example, the growth in city dwellers, increasing rent levels, and the potential for significant, long-term returns. Indeed, as the authors of our German article ([page 14](#)) put it: "What are you waiting for?"

Other topics discussed in this issue include the "Plaza Ban" regulation in Hungary ([page 40](#)); a discussion of the status of hotel operators in Asia and whether it matters if they are agents or independent contractors ([page 52](#)); and the growing trend of block leasing in Sweden ([page 56](#)).

**We do hope that you enjoy reading this issue.**

*"Foreign investors should be aware of pitfalls, including unfamiliar tax regimes."*

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# Australia's foreign investment approval regime

Tim Mathers and Sandra Pepper, Brisbane

Australia has a foreign investment approval regime which regulates foreign persons wanting to acquire an interest in certain Australian land and businesses. This article focuses on foreign acquisitions of Australian land.

The regime is set out in the Foreign Acquisitions and Takeover Act 1975 (Cth) (the Act). Under the Act, the Treasurer of Australia has the power to examine proposed foreign acquisitions and decide whether to:

- issue a “no objection notice,” a process commonly known as granting Foreign Investment Review Board (FIRB) approval for the acquisition;
- prohibit acquisitions determined to be contrary to the national interest;
- order the disposal of an interest already acquired; or
- impose conditions on the acquisition, necessary to remove national interest concerns.

Typically, matters that the Treasurer will take into consideration when making a decision include the impact of the acquisition on the Australian economy and community, national security, and the character of the investor.

Failure to comply with the Act can result in harsh financial penalties and possible criminal prosecution.

## When is the requirement to seek FIRB approval triggered?

A foreign investor should assess the requirement to apply for FIRB approval if the acquisition is a significant and/or notifiable action under the Act that meets prescribed monetary thresholds and no exemptions apply.

The Act defines significant and notifiable actions, and generally an acquisition of an interest in Australian land by a foreign person meets the criteria to be considered a significant and notifiable action. How the criteria are defined and applied is discussed in more detail below.

## Who is a foreign person?

An entity is a foreign person if they meet one of the following criteria:

- an individual that is not ordinarily resident in Australia. This includes Australian citizens living abroad;
- a foreign government or foreign government investor. Commercial investors may also be caught under this definition even though they operate independently of any foreign government, for example if they have some form of foreign government ownership in their shareholding or structure. Pension funds and sovereign wealth funds can also be considered foreign government investors.
- a corporation, trustee of a trust, or general partner of a limited partnership in which a foreign person holds a substantial interest of at least 20 percent; or



- a corporation, trustee of a trust, or general partner of a limited partnership in which two or more foreign persons hold an aggregate substantial interest of at least 40 percent.

### An acquisition of an interest in Australian land is broadly defined

An acquisition of an interest can take many forms, such as entering a contract for the purchase of land and buildings, a call option to purchase or a lease or permit with an expected term of at least five years. Acquiring an interest in an Australian land corporation or Australian land trust, whose land assets comprise more than 50 percent of the entity's total assets, is a deemed acquisition of an interest in Australian land.

For the purposes of the Act, Australian land is classified into four categories:

- **Residential land:** includes land on which at least one but not more than 10 dwellings are built or could be built. It can be land that is vacant or it may have new or established dwellings located on it.

- **Agricultural land:** includes land that is used or could reasonably be used for a primary production business. This may be for the purposes of cultivating crops, animal rearing, fishing, forestry or horticulture operations.

- **Commercial land:** covers land used for a wide variety of commercial purposes and can include land with office buildings, shopping malls, warehouses, industrial estates and factories. It also includes land with residential premises such as hotels and caravan parks, but it does not include retirement villages, aged care facilities or certain student accommodation. It can be either vacant or developed. Commercial land is considered vacant if there are no buildings on the land that can lawfully be occupied by people, goods or livestock. Land is not vacant if a wind or solar power station is located on it.

- **Mining and production tenements:** includes mining, oil, gas and petroleum production (offshore and onshore) acquisitions, leases and permits. It does not include exploration and prospecting permits.

If the land being acquired is mixed use (eg, part commercial and part agricultural) FIRB will assess the classification based on factors including the current and intended use of the land, proportions of each use and the nature of the land.

### What are the thresholds?

The Act prescribes monetary thresholds relevant to the acquisition which, if exceeded (and unless an exemption applies), require the foreign person acquiring the interest in Australian land to obtain FIRB approval before completing the acquisition. The thresholds vary depending on the type of foreign person and the acquisition, for example:

- Is the foreign person a foreign government investor? Foreign government investors are subject to stricter thresholds than other foreign persons and generally there is a zero monetary threshold that applies, so FIRB approval is almost always required.

- Is the foreign person (not a foreign government investor) from a Free Trade Agreement (FTA) country? FTA countries are the US, New Zealand, Chile, China, Japan, South Korea and Singapore. From December 30, 2018, Canada and Mexico became FTA countries. FTA countries have higher thresholds than non-FTA countries.
- Is the land classified as sensitive land? If so, it will have a lower monetary threshold. Sensitive land includes mines and public infrastructure such as an airport or port, and land that houses certain telecommunications or data facilities.
- For agricultural land, the threshold is cumulative based on a foreign person's total holding, meaning all Australian agricultural holdings of the foreign

person must be taken into account when assessing the thresholds.

- Vacant commercial land has a lower threshold than developed commercial land, so careful consideration should be given to the structures that exist on commercial land.
- Where an acquisition involves multiple titles with different uses, notification requirements and thresholds will be determined on a title-by-title basis.

The table below contains the prescribed monetary thresholds for acquisitions of interests in land for 2018.\* These thresholds are indexed annually on January 1 every year.

TYPE OF FOREIGN PERSON	ACTION (TYPE OF ACQUISITION)	THRESHOLD IN AUSTRALIAN DOLLARS — MORE THAN
All types of foreign persons	Residential land	AU\$0
Privately owned foreign persons from Free Trade Agreement (FTA) countries	Agricultural land	For Chile, New Zealand and the US, AU\$1,134 million
		For China, Japan, South Korea and Singapore AU\$15 million (cumulative)
	Vacant commercial land	AU\$0
	Developed commercial land	AU\$1,134 million (regardless of whether the land is sensitive or not)
	Mining and production tenements	For Chile, New Zealand and the US, AU\$1,134 million
Others AU\$0		
Privately owned foreign persons from non-FTA countries	Agricultural land	For Thailand where land is used wholly and exclusively for a primary production business AU\$50 million (otherwise the land is not agricultural land)
		Others AU\$15 million
	Vacant commercial land	AU\$0
	Developed commercial land	AU\$261 million
		Low threshold land (sensitive land) AU\$57 million
Mining and production tenements	AU\$0	
Foreign government investors	Any interest in land	AU\$0

\* This table does not contain reference to Canada and Mexico which became FTA countries on December 30, 2018. Readers should contact our Australian offices directly for further information on the relevant thresholds for these countries.



*Despite the seemingly onerous nature of the FIRB approval requirements, the Treasurer will usually only exercise a discretion to prohibit an acquisition in exceptional circumstances.*

### What are the main exemptions?

The Act provides for various exemptions and some of the more regularly applied exemptions include the following:

- An interest in land acquired directly from the Commonwealth, state or a local government body is generally exempt from the need to apply for FIRB approval.
- Residential land in integrated tourist development areas may be exempt from the need to apply for FIRB approval.
- Where an exemption certificate has been granted, the Treasurer may grant exemption certificates to foreign persons with a high volume of acquisitions, which are not contrary to the national interest, to ease the regulatory burden.

### What does this all mean for foreign investors looking to invest in an interest in Australian land?

Understanding when and how Australia's foreign investment regime applies can be a complex and nuanced process. Given the harsh penalties for non-compliance and relatively high application fees, each proposed foreign acquisition requires careful analysis. It is important to assess all the circumstances of the proposed acquisition at an early stage, to identify any issues and develop a strategy to manage the factors that may cause delay or put the acquisition at risk if the necessary FIRB approvals are not obtained.



Despite the seemingly onerous nature of the FIRB approval requirements, the Treasurer will usually only exercise a discretion to prohibit an acquisition in exceptional circumstances. There have been some high-profile and controversial decisions recently; however, in our experience the vast majority of applications for FIRB approval for proposed acquisitions are accepted and approved by the Treasurer.

Even for what might be considered a routine application, it is important to follow the correct process, given the potential consequences if FIRB approval is not obtained or applied for when it should.

**Our team regularly deals with FIRB across a wide range of transactions and sectors and are well placed to assist foreign investors in all aspects of their real estate investment in Australia.**

# Foreign investment in Brazil (and in Brazilian farmlands)

Marcus Bitencourt and Ivandro Trevelim, São Paulo

In terms of corporate law, foreign investors in Brazil — either legal entities or individuals — do not face a broad range of legal restrictions and, in general terms, are permitted and welcome in the vast majority of economic sectors.

Foreign direct investments, which are regulated by Brazilian Law 4,131/62, may be carried out by investing in an existing company or incorporating a new one. For foreign direct investments, both the Brazilian entity and the foreign investor must be registered with the Brazilian Central Bank. Additionally, every inflow and outflow of money resulting from such investment must be registered with the Central Bank. These registrations are simple online procedures and do not require any prior review or authorization by the Brazilian Central Bank.

Foreign shareholders, as well as Brazilian entities, must also provide the Brazilian Federal Revenue with information regarding their respective corporate chains up to the individuals deemed their “ultimate beneficial owners.”

Notwithstanding the straightforward legal framework which allows foreign investors into Brazil, social and economic aspects, such as the political environment, high interest rates and the expensive debt market, may impact the inflow of investments.

According to data collected by the Brazilian Central Bank, during 2017, Brazil received US\$540 billion in direct foreign investment, which represents an increase of 12 percent in comparison with 2016.

The Brazilian real estate market has also experienced a period of gradual economic recovery. There are a number of positive factors creating good investment opportunities in the Brazilian real estate sector, including:

- **Logistics and warehousing:** the need for warehouse space has increased significantly, as

online retailers need storage units and delivery facilities.

- **Hospitality:** recent major sporting events in Brazil, such as the World Cup and the Olympics in Rio de Janeiro, have allowed this sector to continue to develop and attract resources.
- **Commercial and office buildings:** vacancy rates have been decreasing, particularly in São Paulo, and there may even be untapped demand over the next few years. The return of investment is already driving many real estate developers to launch new commercial real estate developments.
- **Residential:** new developments are taking place for compact and studio apartments, notably in urban areas, such as Brasília, São Paulo, Rio de Janeiro, and other major cities.



- A recovery in the **retail industry** sectors has also been noted, with the return of consumer confidence in purchasing goods and real estate associated with some improvement in the Brazilian economy.
- **Shopping malls** too are now indicating that business developers have begun to re-open stores that had been closed in the recent period of austerity.

New technologies also are perceived to be responding to the demand for a more participatory world, developing very attractive real estate products that meet new demands such as co-working, a flexible working model in which the sharing of office space and resources takes place, bringing together people who do not work for the same employer,

or in the same area. This disrupts the traditional forms of working arrangements.

Other ways to set up households are emerging, with the co-living concept. Co-living projects already correspond to an important trend reflecting the desire for co-existence. This sector delivers individual rooms with common services and areas of all kinds to meet the needs of particular groups, and it is attracting notable interest from older people and students.

Other areas should also generate new business opportunities in real estate, such as the current discussion on amendments to the new Zoning and Master Plan in the City of São Paulo which will affect new real estate developments in the city.

Regarding investment in Brazilian farmland, in 2010, at the end of the government of former President Lula, there was a change in the position adopted by the Office of the General Counsel to the Federal Government (AGU), consisting of the new Opinion<sup>1</sup> which re-established restrictions on the acquisition and lease of farmland by foreigners and similar entities (ie, Brazilian subsidiaries of foreign companies, controlled by foreigners in any way).

The intended purpose of this Opinion in 2010 was to stop all investments in Brazilian farmlands by foreigners, and this intention was achieved, since the change in the interpretation of the legislation resulted in the classification of all and any externally originated investment as subject to the Legislation of 1971. This prevents acquisitions and leases without the prior approval of the government/ National Congress, and also makes them subject to other extensive limitations established by the law. In reality, it renders such deals unviable, adversely affecting all

*There are a number of positive factors creating good investment opportunities in the Brazilian real estate sector.*

<sup>1</sup> Opinion CGU/AGU LA 01, of August 9, 2010

and any type of acquisition or lease, disregarding the important nuances and the existence of economic sectors with their own regulations, such as the energy generation industry.

Currently, a foreign investor may only hold a minority stake in a Brazilian company holding farmland. This restriction may also prevent the granting of guarantees and collateral related to the farmland to foreign investors, which could improve the growth of the agribusiness sector, including the development of new technology.

However, the recently elected president and the Ministry of Finance are now keen to facilitate foreign investments in order to leverage the Brazilian economy. Thus, it may be opportune to reconsider whether the political and economic reasons for the restrictions are still justifiable, or whether the time has come to find a better way to deal with investment in Brazilian farmland by foreign companies.

Times have changed, and if the economy is to grow again, Brazil requires fresh investments. Economists now agree that this will only happen if foreign investment is encouraged, especially given the restrictions on credit.

It is important to approach this question afresh, examining not only the implications for every sector of the economy, avoiding the “catch all situation” set out in the opinion of 2010 which made any deal unfeasible, but also considering a new regulatory framework, one that will achieve a better balance between national security and the country’s economic development.

It would not be the intention to completely eliminate restrictions on the acquisition and lease of farmland by foreigners. Several countries, to a greater or lesser degree, impose such limits and restrictions, but they are generally supported by rules that are clear and easy to implement. The intention would be to make such transactions subject to rules that are clear and subject to penalties for those who fail to comply, thus ensuring investment that benefits the nation’s economic growth.

New investment could boost Brazil’s economy and generate growth for Brazilians by creating jobs and income, and also foster competition in agribusiness. Brazil is currently searching for the right path to take between the alternatives presented, namely, continuing to preclude foreign investment and its attendant development, or to achieve a balance between foreign interests and those of the Brazilian population.

Brazil as a whole, and its real estate market in particular, has been experiencing a gradual but significant period of recovery in growth and investment. As a result, there are many excellent investment opportunities in Brazil and the Brazilian real estate sector that could be attractive to foreign investors.

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**Campos Mello Advogados is an independent law firm working in cooperation with DLA Piper.**





# Foreign real estate investments in Germany — unlimited opportunities?

Fabian Mühlen, Frankfurt and Julius Warda, Cologne

The German real estate market continues to be seen as one of the most stable investment destinations in Europe. It offers great opportunities for investors who are seeking the security of a European economic powerhouse together with a real estate market that has both stable core assets and hidden gems for those who have a higher risk profile. Interest rates have remained low and cities such as Munich, Hamburg and Frankfurt have strong local microeconomic climates that have helped ensure stable and — despite declining in recent years — still attractive yields for investors looking for safe-haven investments.

But Germany offers more than that. Highly educated employees, comprehensive infrastructure, low inflation, economic and political stability and the lack of restriction on foreigners purchasing property make Germany an attractive destination for real estate investors from all over the world.

This article highlights the opportunities available for foreign investors seeking to profit from the real estate market in Germany and the legal requirements and procedures that must be followed in order for them to do so.

## No country-related restrictions

Full ownership is the most complete and comprehensive right over real estate in Germany. Ownership of the property includes ownership of all constituent parts of the property (*notwendige Bestandteile*), including all buildings located there and everything above and beneath the surface of the land (unless the rights have been granted to a third party). Ownership is registered in the land register and that is proof of ownership to everyone with a legitimate interest.

Unlike many other countries, Germany does not generally impose limitations on foreign real estate investments. There is also no difference between ownership by a natural person and a legal entity, simplifying investments from foreign states and jurisdictions.

Only a few restrictions affect certain purchasers regardless of their nationality. Due to reasons of national and governmental interest, acquisition of agricultural property, property located in publicly announced land reallocation areas or urban improvement areas and transfer of property within the territory of the former German Democratic Republic may be subject to the requirement for a public permit authorizing the transfer. In addition, the local authority or municipality may have a legal right of pre-emption to acquire the land. However, this right is usually waived.

In summary, there are no country-related restrictions when purchasing property in Germany and the same rules apply for every party interested in property acquisition.

## Acquisition of ownership

In Germany there are in principle two ways of acquiring property. Either the property can be acquired directly (asset deal) or the legal entity owning the property is purchased, accompanied by a transfer of the ownership (share deal). In order to be valid, agreements for the transfer of property must generally be in the form of a notarial deed. The deed must cover all relevant aspects of the acquisition. Any kind of side letter or agreement that amends the contents of the notarial deed either orally or in writing may result in the



purchase agreement being invalid. Additionally, every property in Germany is recorded in the land register. To complete the transfer of ownership, the new owner must be registered in the relevant land register. The change of ownership is effective from the date of registration.

As mentioned above, a public permit may be required prior to a transfer of property. The permit is usually requested by the notary. The notary also applies for the waiver of the local authority's pre-emptive right (also referred to above) and the tax clearance certificate. The latter is issued by the tax authorities after the payment of any real estate transfer tax (RETT) which may be payable on the transfer.

Besides permits and notarial certification, foreign investors assigning a legal representative to act in Germany must bear in mind the legal provisions regarding power of representation. The document authorizing the representative must be in German and foreign investors need a certificate evidencing their corporate status (*Existenzbescheinigung*) and representation (*Vertretungsbescheinigung*). These documents must be notarially certified in the same way as the purchasing contract in order to be valid. In addition, if they are certified by a foreign notary, an apostille has to be attached to the documents.

It is then common practice to authorize the notary who notarized the transaction to make all necessary (public) applications and declarations in order to effect the transfer of the property. Notaries are entitled to be paid pursuant to a legally binding fee order. The law prohibits any agreement on lower notarial fees; however, fees are capped at a transaction value of €60 million. Notaries are regularly investigated to ensure that the fee order is observed. The declaration of transfer of ownership itself must be contained in a notarial deed issued by a public German notary. Transaction costs for the transfer of property to cover registration fees, notarization, etc. can be estimated at 1.5 percent of the purchase price. RETT currently varies between 3.5 percent to 6.5 percent, depending on the German Federal State. This excludes costs for due diligence and the involvement of lawyers and technical experts. There are ways to avoid RETT; however, tax reforms are currently being enacted in order to reduce the available tax prevention schemes.

## Outlook

It is clear that the German real estate market is an investment-friendly stronghold located in the heart of Europe. Foreign investors are not faced with any particular restrictions but instead enjoy equal rights and obligations when it comes to acquiring property. Due to the growth in the number of city dwellers, increasing rent levels and a secure and attractive environment, real estate owners can profit and grow accordingly. In short, the German real estate market is a place for every serious investor to take an active part. What are you waiting for?

# Real estate foreign investments in Morocco

Christophe Bachelet and Gaëtan Rogeau, Casablanca and Myriam Mejdoubi, Paris

Morocco is increasingly becoming a strategic target for international investors seeking to diversify real estate investment opportunities.

This is the result of many interacting factors, particularly the fact that it is by far the most politically stable country in the region, with constant economic growth, strong positioning as a gateway to Africa with several successful free trade zones, an excellent geographical position between Europe and Africa, a legal framework based on the European civil legal framework and foreign investor-friendly foreign exchange regulations.

The real estate sector still represents more than 50 percent of Foreign Direct Investment (FDI) in Morocco in recent years according to the United Nations Conference on Trade and Development. The main foreign investors are Chinese, North American, Emiratis, French, Spanish and German.

The main areas of real estate foreign investments in Morocco are the following:

- **Healthcare:** Since the 2015 healthcare liberalization law, many foreign investments have been made in this sector. Most of them relate to the creation and development of significant new city

projects, such as the Marrakech healthcare city and the Saudi German Hospital medical facility for the new eco-city of Zenata.

- **Hospitality:** Hospitality has long been associated with Morocco and is driven by the major tourist destinations of Marrakech and Agadir. Investors have continually invested in this area and keep doing so. Many projects have been launched in the last year, in particular in Tangier, Marrakech, Rabat, Casablanca and Agadir. Almost all major operators have a presence in the country (Hyatt, Radisson, Four Seasons, Fairmont, etc.) and others, such as Hilton or Marriott, are planning a return to Morocco with expansionist strategies.

- **Industrial (plants and logistics units):** Many European companies are seeking to develop their capacity in Morocco in order to boost their sales through Africa. Industrial projects are mainly located in the Kénitra and Tangier tax-free zones. Morocco is also part of the Chinese government project, "One Road One Belt," and

the north of Morocco will host a new city project dedicated to this project, for which 400 international investors are expected to apply.

This article briefly answers the questions most commonly raised by those with an interest in foreign investments in Morocco.

## What type of special purpose vehicle or holding company?

First, Morocco does not generally require investors to partner with local shareholders and any foreign company is free to incorporate a company in Morocco without restrictions on the percentage of share capital to be held (except for certain regulated activities). A prior anti-trust merger clearance process is usually required for any joint venture projects since the notification materiality thresholds are very low.

Limited liability companies are commonly used because shareholders' liability exposure is capped to the amount of their contribution to the share capital.





*The real estate sector still represents more than 50 percent of FDI in Morocco in recent years.*



Two main legal entities are used:

- **SARL company:** in terms of share capital requirements, there is no minimum share capital requirement, and therefore the share capital can theoretically be MAD1. Generally shares of companies amount individually to at least MAD100. A SARL company may be formed by only one shareholder provided that its shareholder is not itself a sole shareholding entity.
- **SA company:** a joint-stock company must have at least five shareholders, who can either be corporate entities or individuals. It must have a minimum fixed share capital of MAD300,000 (MAD3 million to proceed with public offering).

Many projects are made through investment agreements which provide a detailed outline of the project and which also include a shareholder agreement. This SA corporate form must be privileged for lodging any shareholders' agreement.

Additionally, it is essential while structuring a joint-ventured project to ensure that public authorizations (eg, construction permits) are made in the name of the project companies and that they own the real estate asset or the going concern to secure the financing.

### What type of registered office?

A registered office may be obtained through one of the following:

- The purchase of owned property: it is possible for foreigners to acquire land or buildings (except those in the agricultural sector). Land ownership regimes are very specific in Morocco and it is important to obtain professional advice prior to any acquisition, particularly for properties that are not registered in the land registry. Acquisition of shares is to be preferred to asset deals since the former is generally subject to a more beneficial tax regime. The split of real estate ownership and operation of the underlying activity may also have tax implications, which should be considered. In terms of projects on greenfield sites, various legal constraints may apply which can significantly affect the transaction structure or may delay the signing of the contractual documentation (guarantee of a promoter to be obtained, certain initial work to be carried out on the plots of land).
- Lease agreement: leases can either be civil, professional or commercial. Rents and charges are freely negotiated between the parties. Commercial leases offers security of tenure since the tenant

has a right of renewal of the lease upon expiration. In practice, rents may be subject to a 10 percent increase every three years. A 2016 law has made significant changes in the Moroccan commercial lease regime in order to balance the relationship between the landlord and the tenant. Long-term leases may give rise to tax constraints, to be assessed on a case-by-case basis.

- Domiciliation agreement: this temporary agreement is often used to incorporate a company and start operations while looking for suitable premises. For tax reasons, however, it must remain temporary. Reform regarding where companies may be domiciled is pending.

### Are there controls for funds into and out of Morocco?

#### INFLOW OF FUNDS INTO MOROCCO

The foreign exchange regulations in Morocco have been significantly relaxed over the last few years. Generally, there are no limitations on foreign investments, especially for inflow of funds into Morocco, irrespective of the type of company, except in some specific business sectors such as agriculture, fishery, insurance or audio-visual.

The Foreign Exchange Charter provides for regular reporting obligations from foreign investors and local companies with a foreign shareholding.

#### OUTFLOW OF FUNDS FROM MOROCCO

In terms of upstream of funds, the following main forms of repatriation of funds for the benefit of foreign investors are not subject to prior authorization by the Foreign Exchange Office (FEO), provided that the revenues to be upstreamed derived from an initial investment financed in foreign currency and other formalities have been met (including the effective payment of any applicable taxes):

- rental incomes
- dividends
- profits made by Moroccan branches of foreign companies
- interests on shareholders' loans
- proceeds from sale of shares and assets or liquidation of a Moroccan company

Where the form of repatriation is not expressly provided for in the FEO instruction, prior approval of the FEO is required.

*These new real estate investment schemes are expected to boost the real estate sector further and to create significant portfolios in Morocco.*

### **Can foreign companies file for a building permit?**

According to the 2019 'Doing Business' rating, Morocco scores very highly (no. 30 out of 160 countries) on its procedure, time and costs for obtaining a building permit.

As in many countries, a local architect must be appointed for the filing of the request.

Depending on the size of a project and its impact in terms of local jobs and key concerned sectors (such as energy, education or healthcare), a prior agreement may be made with the Kingdom of Morocco in order to speed up the process for obtaining town planning permits and to gain certain tax advantages. However, these are subject to compliance with a series of commitments (quota of local jobs to be met, related infrastructures to be financed and built, etc.).

For most construction projects, several contractors are involved and it is rare to have only one general contractor that takes full liability for the entire project.

### **Is there a status that gives tax advantages to foreign companies with subsidiaries in Morocco?**

The Casablanca Finance City status (the CFC Status) offers various tax benefits. Similarly, Tangier and Kenitra may offer advantages worth considering, such as custom duties exemptions or payments in foreign currencies.

### **Development of real estate collective investment schemes (OPCI) as the next step for foreign investments**

Based on the French model, real estate collective investment schemes (OPCI) were recently introduced in Morocco, subject to various laws and regulations.

The main purpose of these vehicles is the construction or acquisition of real estate assets with a view to leasing them to third parties.

The setting up of an OPCI is subject to prior agreement from the Moroccan Stock Exchange Authority (AMMC), and the OPCI has to be represented by a portfolio management company (*société de gestion*) also approved by the AMMC.

These new real estate investment schemes are expected to boost the real estate sector further and to create significant portfolios in Morocco, which may attract foreign investors in the coming years.

Although it is fair to say that more needs to be done before Moroccan REITs are fully effective, expectations are high and there has been significant lobbying for the 2018 finance law to offer a more attractive tax regime for investors.

### **Conclusion**

Investing in Morocco is, for many real estate foreign investors, the first step in an expansionist strategy towards Africa. The country's legal framework is adapting fast in order to secure foreign investments and, where gaps do exist, it follows the example of civil law countries. The ongoing reforms in both the securities law and the criminal code look set to strengthen the enforceability of deeds of sale and title ownerships.

# The 2019 Dutch tax plan — key takeaways for inbound real estate investments

Sebastiaan Wijsman and Rhys Bane, Amsterdam

2018 was a turbulent year for inbound real estate investments in the Netherlands. The Dutch government announced the possible introduction of a conditional withholding tax on interest and royalty payments to low tax jurisdictions and its plan to abolish the dividend withholding tax. However, due to public pressure, the dividend withholding tax was not abolished in the end. Furthermore, the 2019 Tax Plan contains new interest deduction rules and measures on the depreciation of owner-occupied real estate.

The abolition of the dividend withholding tax in its current form would have had an impact on inbound real estate investment via fiscal investment institutions (FIIs), a Dutch collective investment vehicle that, among other things, functions as the Dutch real estate investment trust (REIT) regime.

This article clarifies the current points of interest from a tax perspective for inbound real estate investments in the Netherlands.

## Plans to abolish the dividend withholding tax

The coalition parties included the plan to abolish the Dutch dividend withholding tax in the coalition agreement dated October 10, 2017. As Budget Day takes place on the third Tuesday of September in the Netherlands, the legislative proposal was published on September 18, 2018. Prior to and after the publication of the proposal, various news outlets, opposition parties and lobbying agencies spoke out against the proposed abolition. After Unilever abandoned its plan to move its headquarters to the Netherlands on October 4, 2018, which was a major reason for the abolition of the Dutch dividend withholding tax, the Dutch government announced on October 5, 2018 that it was reconsidering the proposal it had published on Budget Day 2018.

On October 15, 2018, the Dutch government announced that it was no longer abolishing the dividend withholding tax in its current form but was instead going to further lower the Dutch corporate income tax rates, continue to allow direct real estate investments by FIIs and introduce a number of other measures benefitting companies.

## The Dutch REIT regime

Dutch REITs (and FIIs in general) can take a number of legal forms. REITs can be set up as Dutch public limited liability companies (NV), private limited liability companies (BV) or open-ended collective investment funds (FGR) or any comparable legal form of EU/EEA Member States or tax treaty jurisdictions. REITs must meet a number of requirements (eg, limited debt-financing (60 percent for real estate assets), specific types of shareholders, obligation to distribute all of its profits within eight months after financial year-end, etc.). FIIs may invest in real estate (they may not, however, develop any real estate) directly or indirectly (eg, by owning shares in a REIT) and are subject to Dutch corporate income tax at a rate of 0 percent (*viz.* they are *de facto* exempt from Dutch corporate income tax).

In practice, FIIs have subsidiaries that develop real estate, whilst the FIIs own the real estate.



## Relationship between the Dutch REIT regime and the Dutch dividend withholding tax

As Dutch REITs generally only have to pay Dutch dividend withholding tax, the abolition of the Dutch dividend withholding tax would mean that Dutch REITs would not be subject to tax at all. As such, the proposal to abolish the Dutch dividend withholding tax was accompanied by a proposal to abolish the Dutch REIT regime (viz. to disallow direct real estate investments by FIIs). The logical consequence of keeping the Dutch dividend withholding tax in its current form was, therefore, to not abolish the Dutch REIT regime.

## Recent case law concerning the REIT regime

On November 27, 2018, a decision by the Zeeland-West-Brabant court was published in which a German REIT, known as an "Immobilien Sondervermögen," investing in Dutch real estate, was allowed to apply the Dutch FII regime. The effect of this decision is that a foreign REIT applying the Dutch FII regime is subject to 0 percent Dutch corporate income tax and is, in principle, not subject to Dutch dividend withholding tax. As such, Dutch real estate investments can be made tax-free.

## Debt financing

For inbound real estate investments with a non-REIT structure, the newly introduced interest deduction rule,

allowing for the deduction of net interest expense (the net of interest income and interest expense) up to the highest of (i) 30 percent of a taxpayer's earnings before interest, taxes, depreciation and amortization (EBITDA) or (ii) €1 million, does have an impact. This limitation had to be introduced to comply with EU law, therefore every EU Member State has a similar rule as of 2019.

The EBITDA and €1 million limit apply per taxpayer. Therefore, it may be more efficient to use a separate company for every real estate investment (and to not apply the Dutch tax consolidation regime).

As FIIs are subject to a corporate income tax rate of 0 percent, the complicated Dutch limitations on the deductibility of interest are not relevant for an FII.

## Depreciation of owner-occupied real estate

As of 2019, owner-occupied real estate may be depreciated to 100 percent of the value for Valuation of Immovable Property Act purposes. This limitation already applied to non-owner-occupied (eg, investment) real estate.

## Conditional withholding tax

In an effort to combat tax avoidance, the Dutch government has announced its plans to introduce a conditional withholding tax on interest and royalties paid to creditors/licensors established in "low tax jurisdictions" and in certain

specific abusive situations as of 2021. A low tax jurisdiction is either (i) a jurisdiction listed on the EU list of non-cooperative jurisdictions or (ii) a jurisdiction without corporate income tax or where corporate income tax is levied at a statutory rate of less than 9 percent.

This list of low tax jurisdictions already exists for controlled foreign company (CFC) rule purposes and contains (for 2019): American Samoa, American Virgin Islands, Anguilla, Bahamas, Bahrain, Belize, Bermuda, British Virgin Islands, Cayman Islands, Guam, Guernsey, Isle of Man, Jersey, Kuwait, Qatar, Samoa, Saudi Arabia, Trinidad & Tobago, Turks and Caicos Islands, United Arab Emirates and Vanuatu.

## Conclusion

Although the change of heart over abolishing the Dutch dividend withholding tax is not beneficial for companies listed on a stock exchange (where its investors cannot credit the withholding taxes), it is a blessing in disguise for Dutch REITs, as the Dutch REIT regime may have been abolished alongside the Dutch dividend withholding tax.

**We will keep you updated on any further developments concerning the Dutch REIT regime. It is highly likely the Dutch tax authorities have appealed the Zeeland-West-Brabant court's decision. The decision has also not gone unnoticed by the Dutch Ministry of Finance and may lead to future changes in the Dutch REIT regime.**

# Foreign real estate investment in Poland

**Michał Pietuszko and Anna Ziemian, Warsaw**

Poland is currently considered an excellent market for foreign investment. It was the only economy in the EU that managed to avoid recession during the most recent global financial crisis, and between 2008 and 2016 Polish GDP increased cumulatively by 32.4 percent — the third best result in the EU.





Poland has become one of the major providers of real estate investment assets for investors, with the participation of foreign capital in Polish real estate market estimated at around 90 percent. With a yield of 5.25 percent in the primary office market and 6.75 percent in the warehouse market, Poland is powering ahead of other Central and Eastern European (CEE) countries and continuing to attract more and more investment.

### Retail sector

Although the shopping mall market in Poland is considered by some to be already saturated, there have been several significant entries onto the market recently, including Vroclavia with 64,000 sq.m. of gross leasable area (GLA) and Forum Gdańsk with 62,000 sq.m. of GLA, indicating more developments are still taking place. Market saturation has resulted in greater investment in smaller, independent retail and service facilities, which are cheaper and less time-consuming for investors and which meet the needs of consumers. As the retail park market continues to develop and be stimulated by developers interested

in investing in regional and smaller cities, there are still opportunities for foreign investors to enter this sector.

In addition to investment, we have also seen significant activity related to the consolidation of assets. For example, EPP acquired 19 retail projects, becoming the number one retail GLA owner in Poland. Major acquisitions have also been made by NEPI Rockcastle (12 projects) and Arcona Property Fund (12 projects). South African investors have also made significant acquisitions in the shopping mall market.

### Warehouse sector

In 2016–17, investments in the warehouse market increased significantly. According to Colliers' *Market Insights* annual report, the supply of new warehouse space in Poland reached over 2.3 million sq.m. in 2017 and the total warehouse area exceeded 13.5 million sq.m. The report also predicted the further development of the market for smaller warehouses as well as build-to-suit (BTS) projects. The most remarkable BTS projects in 2018 included 161,000 sq.m. of warehouse space

for Amazon and 130,000 sq.m. for Zalando. The main source of demand for new warehouse projects is the development of third-party logistics (3PL), e-commerce and trade. The logistics sector provides great opportunities for foreign entities that are already active as developers, investors and tenants in Poland.

As well as new investments, there has also been significant transaction activity on the warehouse market. In 2018, European Logistic Investment BV, a company from the Netherlands co-managed by Griffin Real Estate, confirmed the acquisition by Redefine Properties (South-African REIT) of nine logistics parks developed by Panattoni Europe.

### Office sector

Warsaw is the driving force of the office space market in Poland and the main target for investors wanting to increase supply. In 2017, 275,000 sq.m. of new office space was handed over for use in the Polish capital. However, unlike other CEE countries, the Polish office space market is also strongly developing in the regions. In 2017, 455,000 sq.m.

of office space was handed over for use in regional cities, 190,000 sq.m. of which was in Krakow — putting it in second place behind Warsaw in the national ranking.

Developers continue to be highly active, with approximately 880,000 sq.m. of office space planned for handover in 2018. This activity is driven by new companies, including foreign investors, who are — in increasing numbers — setting up operations in Poland, as well as companies already present on the Polish market who are expanding their operations. Transactions on the office space market are also on the rise — in Warsaw alone the total value of transactions in the first three quarters of 2018 amounted to €1.14 billion.

## Legal framework

The basis of Polish civil and administrative law is similar to that of Germany and Austria. However, its regulations are not as strict or detailed as in those two countries, making them more flexible. The Polish system also has some unique features.

First, there are restrictions related to the acquisition of real estate by foreigners. Foreign investors usually conduct their activity in Poland through their own SPVs registered in Poland or in other EU member states, which means they can buy and sell real estate in Poland freely. However, in the case of investors from outside the EU, the EEA and Switzerland, the purchase of real estate is conditional on prior approval from the Minister of Administration and Internal Affairs. This approval may be refused if an objection is raised by the Minister of Defense or — in the case of agricultural land — by the Minister of Agriculture and Rural Development.

Recent restrictions on trade in private and public agricultural real estate, which also apply to foreign investors, are of particular significance to the warehouse market. These restrictions limit the sale of public agricultural real estate, define who may — and who may not — purchase such real estate, and give the National Agriculture Support Institution pre-emption rights to agricultural real estate or to shares in commercial companies that own agricultural real estate.

However, some exceptions in the regulations (eg, trade is possible if the area of a real property is small or if it is designated for non-agricultural use in the local zoning plan) mean that the restrictions do not apply to all agricultural real estate. Despite initial concerns, the regulations have not had a significant effect on the real estate market. Moreover, it appears there are plans to relax the restrictions on trading in agricultural real estate.

Another feature of the Polish legal system is the institution of perpetual usufruct, that is, the right to use and take benefit from another person's property, which is similar to full ownership. The right of perpetual usufruct is established on real properties owned by the State Treasury or local government units. The right is transferable and mortgageable.

## Summary

Despite several unique features that need to be taken into account, the legal framework of the Polish real estate market is flexible and accessible to foreign investors.

Investors have faced a number of practical problems recently, including lack of skilled workers in the construction sector, wage inflation and increasing costs of materials. Nevertheless, with its increasing investment needs and opportunities, Poland remains an attractive prospect.

**According to a survey conducted in 2017 by the Polish Agency of Investments and Trade, Grant Thornton and HSBC, 92 percent of foreign investors who have invested in Poland consider it a good decision and would invest again. With its investment climate rated as 3.7 on a scale of 0–5, Poland offers foreign investors a friendly and stable macroeconomic environment.**



*Despite several unique features that need to be taken into account, the legal framework of the Polish real estate market is flexible and accessible to foreign investors.*



# Portugal and foreign investors

Filipa Arrobas Silva, Lisbon

Portugal is currently considered by many to be the most attractive country in Europe for foreign investment. But what is so special about Portugal? This article argues that Portugal is not only a dream travel destination but also a dream country in which to invest, both in terms of business ventures or real estate. Factors like its environment, friendly people, great weather, democratic government as well as the prevalence of English as the language of business, all combine to support Portugal's international reputation, and its claim to be an excellent location for foreign investors.

Portugal has taken great strides in recent years to boost growth by increasing its competitiveness and simplifying the process of investing and doing business. It has now become much easier to invest in Portugal thanks to reforms in competition law, the employment market, and the tax system — all put in place to further drive economic recovery. The country is currently in the enviable position of having world-class infrastructure, a highly qualified and young workforce, a safe and stable environment and a high standard of investment protection.

A legal framework beneficial to foreign investors has been created as legislation has been adapted to better suit the common rules and practices of a liberal foreign investment system. Government policies have made the promotion

of Portugal's appeal to foreign investors a priority, introducing measures like non-discrimination between domestic and foreign investors (when establishing a business) and by introducing incentives for investors (eg, financial incentives for development business in Portugal, tax benefits, etc.).

After a financial crisis that seemed interminable, the Portuguese economy is now on the rise and looking better than ever. An increase in tourism and growth in foreign investment in Portuguese companies and real estate have gone a long way to ensuring Portugal's financial stability.

Foreign investors have been showing a growing interest in real estate; in 2018 alone, foreign investors were responsible for

almost the entire volume of investment in Portugal in this sector. Indeed, 2018 was a year for records across the board; in investment transactions, and also in office real estate, retail activity, as well as in the level of profitability rates. More than €2.8 billion was traded in commercial real estate assets, which represents an increase of around 33 percent over the previous year.

In recent years, urban redevelopment and regeneration has been on the rise in Portugal, due to a shortage of supply and the increasing attractiveness of the national real estate sector worldwide. Among the most important urban redevelopment and regeneration projects is the “Golden” portfolio, of which approximately 70 percent is estimated to be assets for residential purposes, as well the sale of the “Feira Popular” land and the acquisition of the “Quarteirão de Suiça.”

In particular, growth in Lisbon’s real estate sector is not likely to slow down in 2019. Lisbon is the first destination for real estate investment and forecasts remain optimistic that 2019 will certainly be another very positive year, with the investors looking for “alternative assets.” These include student accommodation and co-living space, and the evolution of serviced apartments and hotels looks set to be the great trend for 2019. Additionally, investors are looking for guaranteed income across the European real estate industry and they are currently showing interest not only in high returns but also for investment security, which Portugal can offer.

Tourism plays a significant role in the Portuguese economy, with Portugal becoming an increasingly attractive destination worldwide. However, the country was not prepared to meet the high demand

for new buildings to satisfy the recent increase in tourist numbers, which has been the driving force for investors to acquire real estate in order to meet this growing demand for tourist accommodation.

With the tourism sector’s sudden growth since 2012, it is not only hotels which have felt the benefit of increased bookings. Short-term rental companies like Airbnb are now generally fully booked throughout the year. This has made properties seem very appealing by safe investment standards. Residents too have started to convert their residential properties into short-term rental apartments when they discovered the low taxation regime applicable to such short-term rentals. However, the high-income rentals are even more appealing as an additional source of stable income.

For the second time in history, the hotel sector has become the third most attractive commercial real estate segment, attracting 8 percent of total investment.

Lisbon hasn’t yet reached its full potential as a tourist destination, meaning that it will continue to be a tourist hotspot for years to come.

While Lisbon has recently received several high-profile awards (Ninthly Europe’s Best Tourist Destination, Cruise Destination and City Break at the World Travel Awards) and it is one of the world’s top 10 cities for corporate events, it remains slightly overlooked as one of Europe’s must-see capitals. It is a growing low-cost and cruise destination, but it still doesn’t attract major markets beyond the British, Spanish, French and Italians. It receives very few Asian visitors, and despite its proximity to the US, American tourism to the city has only now begun to reach significant levels. Lisbon’s future is largely secured by tourism, as the city now receives more visitors than the Algarve. In short, if there is one smart investment in Lisbon, it’s in tourism, particularly in accommodation and downtown cultural activities and in the city’s historic districts.

**The potential for high returns on investment in Portugal is evident. Furthermore, the rules on investing in the country are fairly simple, although of course, seeking legal advice before making any investments is recommended.**



# Private education in Southeast Asia — investment plays and regulatory hurdles

Jonathan Lynch, Singapore

Asia's future is bright. The Asian Development Bank (ADB) projects Asia's collective GDP to increase more than 1,000 percent over the first half of the 21st century. Its resulting US\$174 trillion (at market exchange rates) is to account for half of global GDP by 2050, equivalent to its share of the global population. China and India are championed as the drivers of this macroeconomic shift, but it would be shortsighted to overlook the role that the Southeast Asia nations will play.

Indonesia, the Philippines, Vietnam, Malaysia and Thailand are expected to be among the world's top 25 economies by the half-century mark. The unprecedented growth in these nations should usher hundreds of millions of households into the middle class, and they will, in turn, become major consumers with growing disposable incomes. In the long term, a significant amount of this newly created wealth is expected to be directed towards private education. The short term, however, requires expedited maturation of the private education market to remedy lagging education standards and ensure the creation of workforces capable of achieving the ADB's lofty projections.

Private equity and other investors should be reading the tea leaves, and seeking to capitalize on this necessary market maturation by targeting one or more of the region's private education subsectors: (i) education delivery (eg, pre-K education, K-12 education, vocational education and higher education); (ii) education services (eg, test preparation, curriculum development, student tutoring); (iii) education support services (eg, housing, textbook distribution, catering); and (iv) education infrastructure (eg, property maintenance and information, communications and technology networks).

The upside to investment in Southeast Asia's private education sector is high, but it is not without risk and challenges. Consequently, a diligent investor must understand the available investment plays and potential regulatory hurdles (and the likely government policies to alleviate these hurdles) before settling on the investment structure best suited for its risk appetite and expectation on returns.

## The sale and leaseback play

One play for investing in the region's private education sector is through acquisition and leaseback of land and property assets. This investment play offers the seller access to capital in non-core assets for expansion or return on equity, while also keeping operations seamless, a priority for campuses being showcased as flagships for future expansion under an asset light model. This play offers the buyer predictable cash flow as well as the opportunity to recoup capital investment upon asset disposal. With initial yields in the region currently hovering around 7–10 percent, this lower-risk investment strategy is more suitable for the education delivery subsector, specifically plays for institutes with healthy balance sheets and proven track records.

Western businesses and investors have long relied on the sale and leaseback play to expand education businesses and generate fixed returns. In recent years, this strategy has gained traction in the Middle East, where GEMS Education sold and then leased back two campuses in Dubai, and Promoseven sold-leased back the British School of Bahrain. The verdict is out as to whether this strategy will gain traction in Southeast Asia, but early indications are promising. In 2017, Alpha REIT, a Malaysia-based unlisted REIT, entered into a sale and leaseback with Paramount Corp Bhd, the operator of two international schools, in a transaction valued at US\$38.5 million.

For operators, growth of the sale and leaseback play within Southeast Asia's private education space largely depends on the availability of traditional forms of financing. Family conglomerates tend to be the dominant regional players in real estate and education, but are often overleveraged. Coupled with urbanization and rising land costs, this overleveraging often leads to a restrictive lending environment where a sale and leaseback may be a more palatable financing option.

To attract additional financing, some operators are even sweetening the pot by including operational revenues as a percentage of rental.

For investors (particularly foreign investors) seeking to capitalize on any such tightening of lenders' purse strings, this play requires a thorough analysis of the target countries land ownership laws and most efficient means to retain ownership of the real estate.

Investments into Thailand, for example, may require certain "value add" upgrades to the property in order to qualify for Board of Investment promotion (and preferential tax treatment), and thereafter allow the land to be held outright by the foreign investor; otherwise, a local joint venture partner may be required in light of Thailand's onerous laws on foreign land ownership.

Investments into Malaysia, where foreign ownership of land is relatively unrestricted, may require consents from the state authorities, and confirmation that the land acquisition and business satisfies the purchase price and zoning requirements under the National Land Code and

the Guidelines on the Acquisition of Properties issued by the Economic Planning Unit.

Investments into Indonesia and the Philippines — jurisdictions less friendly to foreign land ownership but more aggressive in promoting private education — may require a joint venture and lobbying with the relevant authorities to demonstrate how the investment strategy ties to nation-building via educational investment.

When seeking to undertake a sale and leaseback in emerging Southeast Asia, the only constant seems to be that no two real estate investments are alike.

### **The greenfield play**

A second play for investing in the region's private education sector is through acquisition of land and development of a bespoke campus for an operator. Upon completion, the developer may either sell the property or lease the property and receive stable returns. If the former, the land ownership restrictions set out in respect to the sale and leaseback play will need to be considered.



*When these laws are passed, Indonesia's higher education sector will go from 0 percent to 100 percent foreign ownership.*

Investors looking at greenfield plays are advised to look out for the supply-demand gaps and government initiatives rolled out to fill those gaps. For example, in 2016, Indonesia implemented reforms that required Ministries and governors to improve and establish more vocational high schools, while issuing directives to encourage educational investment in tourism, maritime programs, food security, creative industries, construction and energy. Similarly, in 2018, Malaysia's education Ministry pledged to make technical and vocational education and training students' first study choice by 2023. Coupled with the local human capital requirements of China's One Belt One Road initiatives, these reforms provide entrepreneurial investors with the opportunity to capitalize on the region's need for a highly skilled workforce.

Not limited to vocational schools, higher education is also the subject of less protectionist reforms. Indonesia, for example, acknowledged in 2018 that legislation is being drafted to open up the university sector, and allow overseas institutions to open campuses. When these laws are passed, Indonesia's higher education sector will go from 0 percent to 100 percent foreign ownership, presenting unique opportunities to first mover foreign operators and investors under a greenfield play.

### **Growth-focused acquisition play**

The third, and the least real-estate focused play for investing in the region's education is through debt or equity investment in a single school operator or, more often, a platform that operates multiple institutions schools. Some of the recent high-profile transactions have included Barings Private Equity Asia and Canadian Pension Plan Investment Board's acquisition of Hong Kong-based Nord Anglia, and Temasek Holding acquiring 30 percent of Singaporean Mindchamps Preschool Fund. These investments tend

to be higher on the risk/return ladder as the investment goes direct to the operating company, often with no real estate to serve as collateral.

While regulations on private education in Southeast Asia tend to be friendly towards foreign investment, there are possible barriers through growth-focused acquisition plays. This is particularly true in Thailand, the Philippines and Indonesia, in none of which is foreign majority ownership of the operating entity permitted. There are regulations on school fee caps in certain countries, such as Malaysia and the Philippines, that would also need to be considered. Furthermore, for operators that may have prospects of listing on a regulated exchange, investors should be wary of whether listing would cause the operator to lose tax benefits, currently a hot button topic in Thailand following the 2018 listing of SISB Co Ltd, the operator of Singapore International School of Bangkok, on Thailand's Market for Alternative Investment.

Against this regulatory landscape, investors in a growth-focused acquisition play should carefully review the local regulations on foreign educational investment to gauge their potential impact on investment returns.

### **Conclusion**

As the economies of Southeast Asia continue to grow, investors will continue to explore opportunities in private education. But the extent to which investors put hard money into the region's education space will depend largely on local governments creating a legal and regulatory environment that is transparent, less restrictive and offers incentives. Fortunately, local governments have recently shown a willingness to create such an environment, which bodes well for Southeast Asia reaching its full potential. It is widely expected that this trend will continue.

# Taxing non-UK resident investors in UK property

Richard Woolich and Matt Davies, London

In the Autumn Budget 2017, the UK government announced substantial changes to the taxation of capital gains made by non-UK residents investing directly or indirectly in UK property.

From April 2019, non-UK resident property owners will pay UK tax on any gains made on the disposal of:

- all commercial and residential property (direct disposals); and
- shares in “property-rich” companies (broadly, companies that derive 75 percent or more of their gross asset value from UK property) where the seller owns (or has owned) 25 percent or more of the shares (indirect disposals).

A special regime will apply to collective investment vehicles (see below). In addition, the ATED-related capital gains tax will be abolished.

## What is the current position?

Non-UK resident property owners only pay UK tax on gains made on certain direct disposals of residential property.

No UK tax is payable by non-UK residents on gains made on direct disposals of commercial property, nor on disposals of “property-rich” companies.

Separate rules already impose UK tax on non-UK resident property traders.





### When will these changes take effect?

The new rules will apply to disposals taking place from April 6, 2019.

However, property and interests in vehicles will be “rebased” in April 2019, so that where capital gains tax does not already apply, only gains accruing after this date will be subject to tax. However, it is possible to use the original acquisition cost to calculate the gain if that would produce a fairer result (although this cannot produce an allowable loss on an indirect disposal).

### Why are these changes being made?

The government wants to align the tax treatment of UK and non-UK resident investors and to discourage the creation of complex offshore structures to hold UK property, which the government believes can facilitate tax avoidance.

In many ways, the UK is simply catching up with comparable jurisdictions, many of which already tax direct and indirect disposals in this way.

### What is the treatment of direct disposals?

Any direct disposal of UK property — whether residential or commercial — by a non-UK resident investor will potentially be subject to UK tax.

### What is the treatment of indirect disposals?

Investors that own or have, in the previous two years, owned 25 percent of the shares in “property-rich” companies will be subject to UK tax on a disposal of those shares, though any shareholding that only temporarily exceeded 25 percent can be ignored if it was held for an insignificant time. In determining whether an investor holds 25 percent of the shares, shares held by certain connected persons are aggregated.

Importantly, no tax is payable on disposals of “property-rich” companies where the property is used to carry on trading activities. This could potentially mean that companies that operate as retailers, hotel-operators or self-storage operators fall outside the new charge.

### Are there any exemptions?

Other than the trading company exemption referred to above, there are no specific reliefs or exemptions that will apply to the new rules.

However, any person that is not subject to UK tax for reasons other than their residence (such as charities, sovereign wealth funds and pension schemes) will continue to be exempt.

Furthermore, existing reliefs and exemptions will apply as they do for UK tax residents. This would include the no gain/no loss intra-group transfer provisions and the substantial shareholdings exemption that may assist “qualifying institutional investors” making indirect disposals.

It is also worth noting that treaty relief may be available to investors making an indirect disposal. Certain treaties (notably Luxembourg) do not currently allow the UK to tax indirect disposals. However, the UK is seeking to renegotiate these treaties (and is in the process of renegotiating the Luxembourg treaty) so this benefit may not last long. Furthermore, the new rules contain an anti-avoidance rule which prevents investors from “treaty shopping” to take advantage of favorable treaties.

### What is the special regime for collective investment vehicles?

The special regime for collective investment vehicles (CIVs) will apply to collective investment schemes, AIFs, REITs and non-UK resident companies that are equivalent to REITs.

By default, offshore CIVs will be treated as companies and their investors will be treated as holding shares. Consequently, offshore CIVs will be subject to UK corporation tax on any gains made on the disposal of UK property, and disposals of interests in offshore CIVs by investors will also be subject to UK tax.

This could potentially add layers of direct tax, without the CIV being able to benefit from any exemptions of the investors. However, the legislation offers two (optional) elections allowing (a) tax transparency and/or (b) an exemption, if certain conditions are met, to mitigate the effects of the new rules (see below).

This treatment does not apply to offshore CIVs that are partnerships, which will continue to be transparent for tax purposes.

Non-resident investors in onshore or offshore CIVs will not benefit from the 25 percent threshold that applies to other investors selling shares in “property-rich” companies, so these investors will be subject to UK tax regardless of the extent of interest they hold in the CIV. Investors that are exempt from UK tax for reasons unrelated to tax residence will continue to be exempt.

### **What is the transparency election?**

Offshore CIVs that are transparent for income tax purposes (such as JPUTs) can make an irrevocable election to be treated as a partnership for capital gains purposes, and therefore be transparent for capital gains too. Consequently, the CIV will not be subject to tax under the new rules, but the investors will be subject to tax on any gains made on the disposal of UK property by the CIV.

It is expected that this election will be most suitable for smaller, joint-venture arrangements where the investors are predominantly or wholly exempt from UK tax. It is likely to be unsuitable for CIVs that have regular changes of investors, as these changes may

trigger regular disposals of other investors' interests in the underlying assets, giving rise to dry tax charges. The election effectively places the investors in the same position as they would have been in had they invested directly in the UK property, although the election has no impact on other taxes (such as SDLT).

### **What is the exemption election?**

CIVs (and companies that are not CIVs) that meet certain conditions may make an exemption election so that they are exempt from tax on gains made on direct or indirect disposals of UK property, but their investors are instead subject to tax on a disposal of an interest in the CIV. This election will mean that the CIV is treated in a similar way to a REIT.

The conditions for, and implications of, making an exemption election are complex. Broadly speaking, an offshore CIV that is a “property-rich” company (or treated as one by the new rules) may make the election if it is one of the following:

- a collective investment scheme, and interests in the scheme are marketed and made available to sufficiently wide categories of investor;
- a “non-close” company with shares traded on a recognized stock exchange; or
- a “non-close” CIV and the CIV's manager reasonably believes that, should all of the assets of the CIV be liquidated and the proceeds returned to investors, no more than 25 percent would not be subject to UK tax because of the allocation of taxing rights under tax treaties.



The election must be accompanied by information about disposals made by investors in the two years prior to the making of the election.

If, after the election is made, the CIV fails to meet the conditions set out above, it will trigger a deemed disposal and reacquisition of the investors' interests in the CIV. In some circumstances, any resultant gains will be subject to tax immediately, whilst in others the tax charge may be delayed.

The election applies to the CIV and any entities in which the CIV has at least a 40 percent interest, and it continues to have effect provided that the CIV provides certain information about the CIV, its investors and entities in the CIV's structure to HMRC on an annual basis.

The election can be revoked by the CIV's manager, or by HMRC if the CIV has not complied with its information obligations to HMRC, or if HMRC considers it appropriate to safeguard the public revenue.

It is expected that this election will be most suitable for widely held funds with large structures, particularly where the investors are exempt and wish to prevent tax charges in the fund that will impact on their returns. It is likely to be unsuitable for smaller, joint-venture arrangements.

### **Are there any changes to the REIT regime?**

Yes. In particular, REITs will no longer be taxed on disposals of "property-rich" companies.

### **What are the next steps?**

All investors, particularly joint-venture and collective investment vehicles, will need to consider the impact of the proposed changes on their investment structures, and the advantages and disadvantages of making the transparency and exemption elections.

**If you have any questions about the proposed changes or you would like to discuss how these may impact your existing business, please get in touch.**

# Leveraging in Denmark — a unique mortgage system

Emilie Møller, Copenhagen

The Danish mortgage system is one of the best in the world for real estate financing, with its unique features making it a highly attractive way to leverage property investments. The system goes back more than two centuries and the Danish covered bond market is today the largest market in the world compared with GDP, and the largest in Europe in absolute terms.

The Danish system is unique, as there is a direct match between the mortgage loan and the covered bonds issued to fund the loan. This provides for a high level of financial stability and forms the basis for transparent competitive loan costs and a flexible early repayment system found nowhere else in the world.

## How does the mortgage system work?

The acquisition of real estate in Denmark is typically financed by mortgage credit institutions, which are dedicated financial institutions permitted only to grant loans against mortgages on real estate funded by covered bonds.

The mortgage system is generally based on a match-funding principle, under which mortgage loans are funded by the issuance and sale of covered bonds with matching payment terms. The market value of the underlying bonds at time of sale determines the mortgage loan rate, thereby ensuring a high level of transparency based on market pricing.

The loans are secured through a mortgage on the borrower's property, and all loans are limited to the statutory maximum loan-to-value ratio based on the assessed value of the property; 60 percent for commercial properties and 80 percent for residential rental properties.

In addition to the property value, the borrower's creditworthiness is individually assessed as part of the credit approval process and the mortgage security will often be combined with other types of security in the form of change of control, negative pledge, limitations on dividend distribution and, depending on the circumstances, pledge over the shares in the borrowing company or suretyship.

## Key advantages of the Danish mortgage system

The Danish mortgage system offers several advantages due to the unique features of the match-funding principle and the high level of security, including:

- Competitive loan costs
- Transparent market-based pricing
- Flexible early repayment options with no penalty
- Long credit facilities (up to 30 years)
- Possibility for interest-only financing
- Mortgage credit institutions cannot terminate the loans except in the event of default

### Loan types

Danish mortgage credit institutions offer three main types of mortgage loans, namely: fixed-rate loans, adjustable-rate loans and floating-rate loans (with or without interest-rate caps), which are all standard loans. Almost all loans may be combined with interest-only periods for up to ten years, subject to individual credit approval.

Fixed-rate loans are typically long-term loans with a term of up to 30 years, providing for a high degree of security as the interest payments are known throughout the term of the loan. A fixed-rate loan can be either a cash loan or a bond loan, where the main difference is that any capital loss on the sale of the underlying bonds is reflected in the interest rate on the cash loan instead of in the proceeds, as is the case with bond loans. Any capital loss on cash loans is therefore tax deductible, as the loss is converted into interest.

With adjustable-rate loans, the interest rate is adjusted throughout the term of the loan at certain intervals from one year and

currently up to ten years, at which time the underlying bonds are redeemed and replaced with new bonds. The yield of the new bonds will then determine the interest rate of the mortgage loan until the next adjustment time. The adjustable-rate loans are cash loans, and any loss or profit on the sale of the underlying bonds is therefore reflected in the interest rate.

The interest rate on floating-rate loans is adjusted at more frequent intervals, generally every three to six months, and the interest rate is typically based on a reference interest rate, usually the Copenhagen Interbank Offered Rate (CIBOR) or the Copenhagen Interbank Tomorrow/Next Average (CITA), plus a premium. A floating-rate loan may be combined with an interest-rate cap.

Whereas adjustable-rate and floating-rate loans provide a lower interest rate, fixed-rate loans provide for equity-value protection in a market with increasing interest rates, as the market value of the fixed-rate loans will decrease when interest rates increase, making it possible to repay the loan at a lower amount.

### Competitive loan costs

The liquidity of the mortgage bond market and the attractiveness of the bonds due to the high level of security ensure low and competitive prices.

The recurring loan costs consist of interest and principal payments as well as a margin charged by

the mortgage credit institutions. The interest rate of a mortgage loan and the repayment price is directly reflected in the price of the mortgage bonds funding the loan. The interest rate is therefore based on the chosen loan type and the market price and is not subject to individual negotiation.

According to the European Mortgage Federation (EMF), Denmark has one of the lowest interest rates in Europe. For foreign investors, it should be noted that Denmark conducts a fixed exchange rate policy, keeping the value of the Danish krone stable against the euro.

The margin charged by the mortgage credit institutions is a percentage of the debt outstanding and corresponds to the interest margin of a universal bank; however, the rate is generally lower. The margin percentage is subject to individual negotiation and may be adjusted during the term of the loan, unless otherwise agreed.

In addition to the recurring loan costs, there will be initial costs such as commitment fees, brokerage and costs for registration of the mortgage in the Danish Land Register. The registration fee amounts to 1.5 percent of the mortgage debt plus a low fixed-fee amount. However, the borrower may, under certain circumstances, be able to reuse registration fees on mortgages already registered on the property.



*Denmark has one of the lowest interest rates in Europe.*

### **Flexible early repayment options**

A common feature of mortgage loans is an early repayment option, providing for a high degree of flexibility for the borrowers in terms of exit and mortgage refinancing in a changing market. These repayment options depend on the loan type.

Fixed-rate loans are based on callable bonds and can always be terminated for early repayment at par value. In addition, the loan may be repaid by purchasing and delivering the same type of bonds as those used to fund the loan.

Adjustable-rate loans are based on non-callable bonds and can only be repaid at par value in the two-month period prior to the interest-rate adjustment. However, the loan may, at any time during the remaining periods, be repaid by delivery of the underlying bonds. The repayment options for floating-rate loans depend on whether the loan is based on callable or non-callable bonds.

It is therefore possible to repay all loan types without negotiation or penalties, but, in case of repayment by delivery of the underlying bonds, the price will be based on the market price for the bonds at time of purchase.

### **No termination without cause**

A final main characteristic of mortgage loans is the borrower's security against termination without cause. Mortgage loans are non-terminable in that mortgage credit institutions are not entitled to terminate a mortgage loan except in the event of default, and the loans are not subject to renegotiation every year as is the case with bank loans.

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**At DLA Piper, we assist our clients throughout the entire lifecycle of their real estate investments, including the financing process in connection with the acquisition of real estate, subsequent refinancing or early repayment in connection with a sale.**



# The “Plaza Ban” regulation in Hungary

Attila Remes and Mátyás Rada, Budapest

In August 2018, the Hungarian government adopted Government Decree No. 143/2018 (VIII. 13) on the detailed rules applicable to the change of designated purpose procedure, which further strengthened the regulation known as the “Plaza Ban.” In particular, it extended the scope of the strict rules prohibiting shops and shopping malls (referred to collectively here as “retail buildings”) with a gross floor area of over 400 sq.m.

As a consequence, the owners of retail buildings with a gross floor area of over 400 sq.m. face a new permitting procedure in case of those (minor) alteration works which were previously not subject to any permits. Additionally, owners are not allowed to change the designated purpose of office buildings, storage or other premises with the intention of expanding the area of their retail buildings, without seeking a permit from the competent authority.

## Legislative background

The rules of the construction, alteration and expansion of retail buildings with a gross floor area of over 400 sq.m. and the change in the designated purpose procedure known as the “Plaza Ban” law are contained in the laws listed below:

- Chapter No. IV/A of Act LXXVIII of 1997 on the Formation and Protection of the Built Environment (the Act) (last amended in August 2018).
- Government Decree No. 143/2018 (VIII. 13) on the detailed rules applicable in the change of designated purpose procedure (the Government Decree), which came into force in August 2018.
- Government Decree No. 5/2015 (I. 29).

Before the recent amendment of the Act and the adoption of the Government Decrees, only the construction, alteration and expansion works carried out in retail buildings with a gross floor area of over 400 sq.m were subject to the “Plaza Ban” rules. As from August 2018, however, there are further restrictions on the owners of larger retail buildings, such as, for example, the requirement of government approval for even minor alteration works.



*As from August 2018  
[...] there are further  
restrictions on the owners  
of larger retail buildings.*

### **The rules of the “Plaza Ban” where a building permit is required**

As noted above, the affected properties are retail buildings with a gross floor area of over 400 sq.m., where the owner intends to conduct construction, alteration or expansion works.

The Act defines retail buildings as shops and shopping malls, and refers to Act CLXIV of 2005 on Trade, which provides more details. Under the Act on Trade, “shops” are such buildings, independent sections of buildings, or areas constructed or used for trading activities where trading activities are pursued. Shopping malls are multi-purpose buildings or multiple buildings consisting of a complex of commercial units, mostly shops, which represent permanently established merchandisers of different types and offer various types of entertainment and leisure services to visitors.

Owners of retail buildings submit their application for a building permit to the local building authority. The local building authority has 75 days to grant the building permit to the applicant.

Within this time limit, it is obliged to obtain prior approval from the government office, which must consider any detrimental impact of the retail building in terms of the local environment, transportation and urban development, and must decide whether that impact outweighs the potential advantages of the construction, expansion or alteration of the retail building.

Before making its decision on the approval, the government office is obliged to discuss its assessment with a committee made up of delegates from the competent ministries. The committee’s opinion must be taken into consideration, although it is not binding on the government office.

Before submitting an application for a building permit, the owner has the opportunity to ask for prior approval of the government office by contacting the office directly. If such prior consent is granted, the owner may initiate the building permit procedure, and the local building authority will not have to obtain the approval of the government office. The owner has one year to make use of the prior approval once it has been granted.



## Changes in designated purpose procedure

The activities which are subject to the new permitting procedure are as follows:

- a) Changing the function of buildings with a gross floor area of at least 400 sq.m. to retail purposes.
- b) Minor alteration of a retail building — where a building permit is not required — where the alteration expands the gross floor area of the building to exceed 400 sq.m.
- c) Minor alteration of a retail building with a gross floor area of over 400 sq.m. — where a building permit is not required.

In relation to point (a), it is no longer possible, without the approval of the government office, to build retail units in buildings with a gross floor area of 400 sq.m. by changing the function of the existing building for retail purposes. So if, for example, the owner of an office building (with a gross floor area of over 400 sq.m.) wishes to convert that into a retail building, they must now initiate the change in the designated purpose procedure.

The change in the designated purpose procedure also governs situations where a retail building is expanded so that its gross floor area will exceed 400 sq.m. (point (b)).

In relation to point (c), it should be noted that a retail unit of a shopping mall does not constitute an independent retail building, thus any minor alteration works carried out in a retail unit will result in the shopping mall being required to initiate the change in designated purpose procedure.

Government Decree No. 253/1997 (XII. 20) on the national settlement planning and construction requirements provides the definition of “alteration works.” These are defined as construction works carried out in order to alter the floor plan or external appearance of an existing building (or part of a building) without expanding the internal volume.

The rules of the change in designated purpose procedure apply, for example, if the owner intends to erect, or take down an internal partition wall or change the location of a fitting room inside a retail unit.

Under the Government Decree, the owner (prior to starting any of the above activities) must submit its application for a permit to the local government. The notary will forward the application to the government office, which has 60 days to grant its approval. Unlike the building procedure, the local notary does not decide whether the permit should be issued or not, as this falls within the competence of the government office. However, the same administrative deadline applies (75 days from receiving the application) and the notary has to obtain the government office's approval within this period.

As noted above, the change in designated purpose procedure covers activities which were not previously subject to any permitting rules. Under the Government Decree, if any of these activities are undertaken without a permit, the owner of the building may be fined or prohibited from using the premises as a retail building.

# Energy performance regulations and investing in Dutch real estate

Arjen de Snoo, Jaap Lameijer and Ernst Haverkamp, Amsterdam

## Introduction

Following high-profile litigation contesting its lackluster approach to meeting its own goals on sustainability, the Dutch State is now faced with a court order that requires it to expedite its efforts to reduce CO2 emissions and ensure a more sustainable society. The real estate sector is key in meeting these requirements and subsequently, is faced with ever tightening regulations.

These regulations increasingly influence the value and costs of Dutch real estate and are therefore becoming of significant importance when it comes to investment decisions and due diligence with regard to Dutch real estate for all those involved in the real estate sector.

In this article, we outline the key legislative developments on energy efficiency and provide insight into what may become the key questions facing real estate sector players in the light of these developments.

## Energy performance label

To ensure the energy efficiency characteristics of buildings is clear for (prospective) owners and users (as well as other parties), the European Energy Performance of Buildings Directive 2002/91/EC (EPB) introduced the energy performance label, which is valid for ten years. The EPB required Member States to adopt legislation stipulating that an energy performance label quoting the building's Energy Efficiency Index is provided in case of the construction, sale and/or lease of the (new) building. The EPB was updated by the European Directive 2010/31, which sets additional ambitious goals with regard to energy efficiency (eg, achieving 20 percent energy efficiency by 2020 and an (almost) energy neutral building environment by 2050).

## NEW DUTCH REGULATIONS ON ENERGY PERFORMANCE LABELS

In November 2018, the Dutch government adopted a new (much)

stricter decree with regard to the energy performance of office buildings in the Netherlands (Besluit inhoudende wijziging van het Bouwbesluit 2012, dated November 2, 2018). In addition to the EPB requirements, this decree specifically requires that each "office building" (defined as buildings which are used for office purposes) should have an energy performance label "C" or higher (this is equal to an Energy Efficiency Index of at least 1.3) as of January 1, 2023; additionally, the decree requires that, as of January 1, 2030, all office buildings should have an "A" class energy performance label.

While the decree does provide a number of exemptions for, for example, monuments and limited floor area office buildings as well as a hardship clause, these are limited since most commercial office real estate constructed in the last 30 years will be fully subject to the new rules. Additionally, given ever-tightening regulations, it is likely



*Most commercial office real estate constructed in the last 30 years will be fully subject to the new rules.*

that due to the stricter regulations (obtaining an “A” class energy performance label) transformation of (office) properties to non-office use will be required.

As a consequence of the regulations, an office building without the required energy performance label can no longer be used as such unless the required label “C” in 2023 and label “A” in 2030 are obtained. The primary responsibility to meet this obligation lies with the owner/lessor of the office building. The risks associated with non-compliance are quite severe, as they may entail the competent authority taking administrative enforcement measures, such as the closure of the office building.

#### POINTS TO NOTE

It is estimated that approximately 15,000 office buildings in the Netherlands do not currently comply with the new requirements and have an energy label of “C” or lower. Therefore, it is expected that many owners/lessors of office buildings

will be obliged to take additional measures and make additional investments to meet this requirement, or repurpose their assets.

In addition, the Dutch government does not currently reimburse or provide additional funds/subsidies for the required works (with the exemption of some tax benefits). As a consequence, owning or buying/ investing in an office building which does not have at least an energy performance label “C” or can otherwise meet the applicable regulations by January 1, 2023, may be considered a financial liability.

The aforementioned obligation should be taken into account when investing in Dutch real estate, especially where it concerns office space. It is also important to take this into account in relation to reviewing and/or concluding lease agreements, especially with regard to costs and the fact that closure of an office building could lead to a material defect and/or breach under the lease agreement.

## Government use of buildings

In addition to the energy label requirements, specifically with regard to buildings used by government, as of January 1, 2019 the (entire) government will only use newly (constructed) buildings in its capacity as an owner and/or lessee which are almost energy neutral. It should be stressed that these requirements will also be relevant to project developers or lessors catering to Dutch government bodies.

## Obligation to take (sufficient) energy saving measures

As well as the above mentioned requirements, which apply to offices in particular, there is also a more general requirement in relation to Dutch (commercial) properties with regard to taking (sufficient) energy saving measures. Dutch environmental legislation (*Activiteitenbesluit milieubeheer*, Activities Decree) requires that any operator (*drijver*) of an establishment (*inrichting*) which uses over 50 KWh of electricity or 25,000 m<sup>3</sup> of natural gas must take all energy saving measures which can be (financially) recovered within five years. Some operators are exempt as they are involved in sector-wide government approved plans (eg, green houses) or participate in the EU ETS.

Note that the definition of an “establishment” is very broad and applies to almost all (commercial) real estate properties, including offices. The operator is defined as the party who could end a violation of a specific rule (in this case: not taking the required energy saving measures).

The operator of an establishment is free to choose the kind and type of energy saving measures but has to demonstrate that the measures taken meet the legislative requirements. To aid operators in efficiently taking measures, the government has included a list with “recognized measures” per sector (*Erkende Maatregelen*), which are included in appendix 10 to the Activities Decree. Taking the measures set out in the appendix means that the property/operator (automatically) complies with legal requirements. This list is regularly updated, most recently on January 1, 2019.

As noted, the operator is free to take any energy efficiency measures; however, any measures not included in appendix 10 should be approved and assessed by the competent authority. The competent authority will then assess whether such measures are sufficient.

Non-compliance with these obligations is subject to administrative penalties (including fines of €10,000 per infringement) and potential criminal prosecution. Every operator of an establishment is required to report to and

inform the competent authority of the measures taken and progress made from July 1, 2019. Such reports are to be submitted electronically to the competent authority once every four years. The draft regulation provides that non-compliance or fraud in relation to the reporting obligations is subject to administrative law enforcement, as well as criminal for false reporting.

## Key observations for sector players

In our view, the new regulations will have serious ramifications for the real estate sector and all sector players. While the regulations impose clear obligations on more or less specific parties which affect them directly, the indirect effects of the obligations may be even more significant.

### LENDERS

For lenders financing assets and asset portfolios, key questions are whether the owners meet their energy performance labels, as non-compliance may put debt service at risk; additionally, non-compliant assets will likely decrease (substantially) in value. Lenders may consider developing products that cater to redevelopment or upgrading of non-compliant real estate.

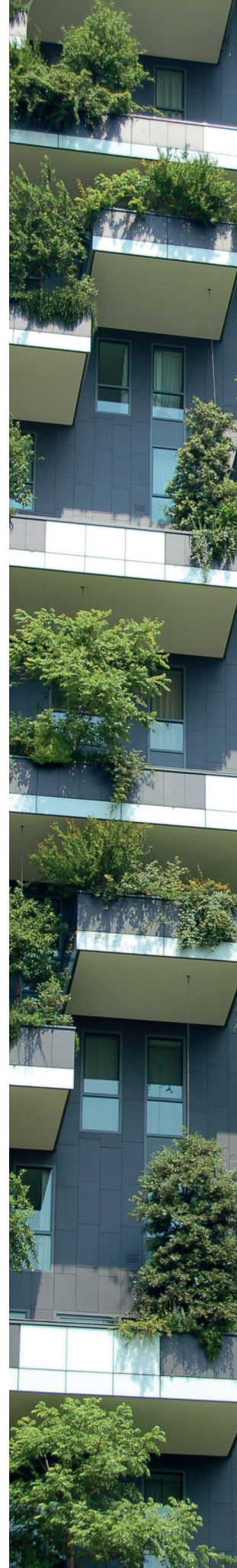
### DEVELOPERS

Developers will be faced with the requirements for new developments with Dutch government contracts being even more specific on energy neutral developments. The new rules on energy performance labels are expected to prompt numerous redevelopment issues both to ensure compliance for office use and — especially in urban areas — transformation developments. Lenders may well have more appetite for, or be willing to invest only in, energy neutral (new) developments which developers may cater to.

### OWNERS

Property owners should have a full overview of their portfolio energy performance labels and the costs associated with energy efficiency measures ensuring the energy label is up to the required level or with transforming the real estate to another use. Asset value effects of non-compliance vis-à-vis compliance as well as running costs should also be factored into the decision to take measures or not.

Additionally, key points for non-compliant assets are whether the lease agreements give the lessee termination rights in case of statutory non-compliance of the property. Where new leases are entered into, lessees can be expected to have specific requirements in this respect.





## LESSEES

For lessees, the key points are whether the leased real estate meets the statutory requirements and whether the landlord is taking measures to address any non-compliances; continued non-compliance risks (and related costs) of having to relocate. Also, lease termination options in case of statutory non-compliance of the property should be considered. It is suggested that additional arrangements should be made with regard to the energy performance label for offices to include, for example, a break-option in the lease agreement in case the competent authority closes the office building after January 1, 2023.

Where new leases are entered into, the above is equally, if not more, relevant.

## Expectations

Apart from the above specific points, the new regulations on the energy performance label raise a number of pending questions which may or may not have been fully appreciated at the time the regulations were drafted. We therefore expect there to be a number of developments in the market, including the following.

### ENERGY PERFORMANCE LABEL AND ENERGY EFFICIENCY MEASURES INTERPLAY

As set out above, there is a clear interplay between the energy performance label requirements and the energy efficiency measures requirements. Key market effects in our view may include a shift from the “recovery” model for the energy efficiency measures, focusing on recovery of financial investments through reduced costs for, for example, energy, towards a model focusing on asset valuation effects of measures and the corresponding energy performance label; any financial assets not

required to operate a building can go into debt service. Lenders will play a key role in facilitating more energy-neutral buildings.

### LESSOR/LESSEE DISPUTES ON ENERGY EFFICIENCY MEASURES

A key legal question in relation to responsibility allocation lies in the “operator” identification. As set out above, both owners and lessees may at times be considered the operator. Given the new regulations, disputes may be more likely between owners and lessees on energy efficiency measures to ensure compliance with both the energy efficiency obligations and the energy performance label requirements.

### DLA PIPER AMSTERDAM

**As a truly international firm but with strong Dutch roots, DLA Piper Amsterdam's Real Estate sector team has over a century of experience and is well equipped to take on any matters relating to Dutch real estate. Our cross-border and cross-practice group approach ensures we have the experience to advise and counsel your company on developments, investments as well as lease matters. Should you have any questions on energy performance labels and energy efficiency measures, please do not hesitate to get in touch with the authors of this article.**

# Roadmap for real estate businesses' second-best investment on earth

Ton van Doremalen, Dubai and Wouter Kolkman, Amsterdam

*“The best investment on earth is earth.”*

This quote promoting real estate investments above all others is often attributed to the 20th-century real estate investor Louis Glickman. The second-best investment for a real estate business, however, may well be a good tax advisor to consider and mitigate the numerous taxes associated with real estate investments. This article serves as a high-level roadmap, setting out different types of taxes that should be taken into consideration when setting up and growing a real estate business.

## Setting up

### PROPERTY OWNERSHIP

The owner of real estate would generally be qualified by tax authorities as the (principal) taxpayer, although users of the real estate (eg, tenant or usufruct holder) may also be qualified as such. The development of a tax-efficient property ownership structure ensures that significant

value is preserved in that investment's lifetime. The most notable levies in this respect are corporate income tax (CIT) and capital gains tax (CGT).

Local CIT may be levied on the profits generated with the real estate, generally the operating earnings minus the deductible expenses. Important aspects to consider include the CIT rate(s), depreciation rules as well as potential deduction restrictions.

In most countries, CGT is levied on the capital gains (profits) made on the sale of an asset that increased in value, such as real estate or a shareholding in a local (real estate) subsidiary. As a general rule of thumb, capital gains derived from real estate are taxed in the country where the asset is located (known as the situs principle). Many jurisdictions have (domestic) rules which also subject the sale of

shares in a real estate subsidiary to CGT. In order to prevent double taxation, tax treaties are routinely concluded between jurisdictions to solidify this principle and to allocate taxing rights. A tax treaty may dictate that only one of the countries may levy CGT. Some tax treaties for example stipulate that a jurisdiction is not allowed to levy tax on the sale of shares in a real estate (rich) company, established in that jurisdiction. Spearheaded by the Organisation for Economic Co-operation and Development (OECD) with its anti-Base erosion and profit shifting (BEPS) project, the international community is in an ongoing process to avoid exploitation of gaps and mismatches between jurisdictions, including with respect to the (improper) use of the tax treaties. In some cases, this also concerns CGT on the alienation of real estate rich company's shares.



While technically not a tax topic, bilateral investment treaties can also be important for international investors. In broad terms, the nationalization or expropriation of investments is typically prohibited under the BITs, unless such measures are taken in the public interest and the host state pays prompt, adequate and effective compensation to the investor. As such, particular attention should be paid to these treaties when envisaging investing in certain high-risk source countries.

rule" (or "thin cap rule" for short). Such a thin cap rule may for example result in interest on debt in excess of four times the equity to be non-deductible. The restriction of deductions would result in a higher CIT taxable base.

Deductibility of interest expenses can also be (further) restricted by formal transfer pricing rules and/or the general at arm's length principle. This principle requires related parties to conclude transactions on an independent basis, ideally

rates depending on the type of real estate (eg, a lower tax rate for residential real estate).

The acquisition of real estate may also be subject to value added tax (VAT) which may, or may not, be recoverable. In certain jurisdictions, a special VAT exception applies in case the acquired real estate is considered to be (part of) a business (the "transfer of going concern"), in which case the transaction would normally not be liable to VAT.



#### FUNDING AND TREASURY

In addition to the ownership structure, the financing structure can be equally important. Payments of dividend and interest may be subject to withholding taxes (WHT). As with the CGT, tax treaties may provide mitigation of WHT by allocating taxing rights to the investor and/or source country.

Returns from your target investment may also be impacted by interest expenses deduction rules. Deduction of interest expenses may be restricted to a certain percentage by means of the "thin capitalization

resulting in fair market prices. Some jurisdictions have formal transfer pricing rules in place, which may require detailed reports to be kept substantiating that transactions with related parties are in line with the at arm's length principle.

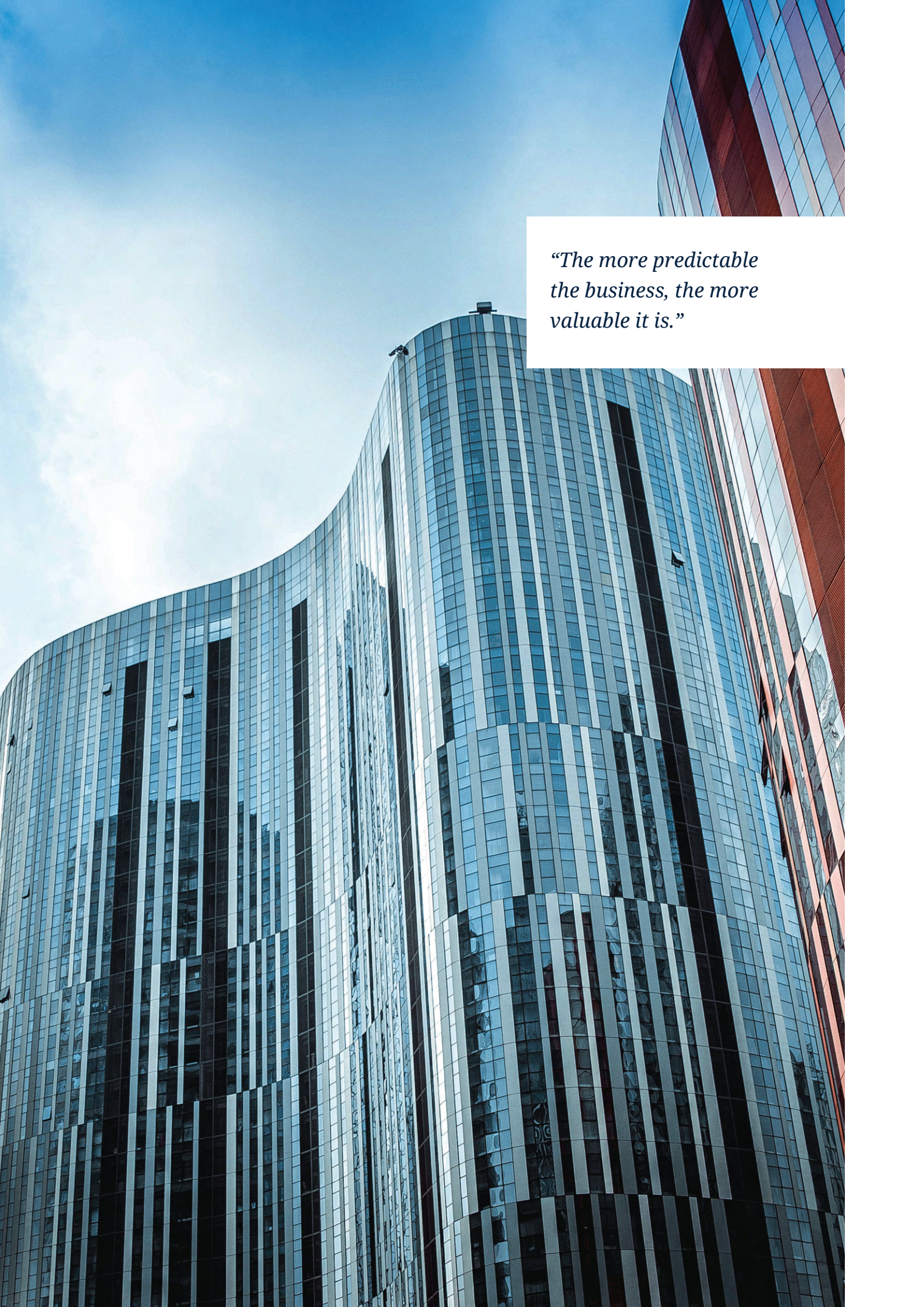
#### LOCAL TAX PLANNING

Different tax aspects and incentives of the target source country should be closely reviewed. The acquisition of real estate (entities) may be subject to real estate (transfer) tax and/or stamp duties. Some jurisdictions apply different real estate (transfer) tax

Some countries may provide tax credits, capital allowances (similar to a tax credit) or certain environmentally driven depreciations/incentives. Depending on the target jurisdictions, all three categories might be considered and could result in a lower domestic CIT basis.

#### INTELLECTUAL PROPERTY PLANNING

Certain types of real estate, such as hotels and restaurants, require a particular brand or formula in order to operate. For tax purposes, such a brand or formula is typically referred to as intellectual property (IP). It is



*“The more predictable  
the business, the more  
valuable it is.”*

not uncommon to assign IP rights to a designated special purpose vehicle which sole purpose would be to license the IP to the real estate operator/owner. IP rights may provide for tax efficient structuring possibilities.

Countries may have transfer pricing and/or at arm's length rules in place requiring licensing fees paid by group entities to reflect the fair market value. In order to ensure an appropriate allocation of the returns from the exploitation of IP, and also the costs related to the IP, it is a globally acknowledged principle to look at the functions of the entities involved, the assets used and the risks assumed in the "development, enhancement, maintenance, protection and exploitation" (DEMPE) functions of the IP. IP, being a relatively easy transferred asset across borders, is one of the OECD's main focus areas. The OECD introduced the DEMPE functions for IP as part of its BEPS project.

## Sustainability and growth

### CASH MANAGEMENT

Once the ownership, financing and/or IP structure is in place, it is important that the day-to-day operations are optimally managed, also from a tax perspective. Taking into account liquidity requirements and internal fund flows, certain arrangements can be designed to achieve full tax efficiency in cash management. This is particularly important for the avoidance of any trapped cash, local expense deduction restriction rules and WHT.

VAT exposure is often hidden in organizations, but can have a major impact on the cash flow, particularly when unrecoverable. It is not uncommon for countries to have long-term revision rules for, among others, real estate. Such revision rules may require taxpayers to keep track of the use of the real estate and, under particular circumstances, repay previously recovered VAT.

Furthermore, some countries may have special incentive schemes for sustainable energy production, environmental investment rebates or arbitrary (or accelerated) depreciation of environmental investments.

### COMPLIANCE AND REPORTING

Operating real estate often triggers registration and filing obligations on both a national level (eg, CIT and VAT) and on a local level (eg, municipality tax). These various obligations may involve time-consuming and complex exercises, in particular for real estate investors active in multiple jurisdictions. Tax reporting policies and/or models should therefore be set up and ongoing compliance should be monitored.

### ACQUISITIONS AND EXITS

Assets and businesses may be acquired by means of an asset deal and/or share deal. The chosen route generally depends on a mix of commercial, legal and tax considerations. In any scenario, due diligence should be conducted to determine historic tax risks and liabilities. Such risks and liabilities, and the integration of newly acquired assets and businesses in existing structures, need appropriate attention.

Based on the location of the target asset and/or the target entity, analysis should be undertaken to determine the most tax efficient acquisition structure, also taking into consideration a potential future exit. A proper exit from an investment should always ensure that tax does not wipe out significant returns on investment.

### Concluding remarks

From the acquisition up to the sale of real estate, a myriad of taxes may be applicable to "earth's best investment." All real estate transactions should therefore be carefully examined and planned, including from a tax perspective to ensure tax efficiency.

# Is your hotel operator an agent or independent contractor, and should owners in Asia care?

**Jonathan Lynch and Teerin Vanikieti, Singapore**

Hotel development in Asia Pacific is witnessing an impressive rise. The region's hotel construction pipeline (excluding China) has grown over 300 percent over the past decade. Currently, there are over 1,000 hotels under construction, with Indonesia, India, Japan, Thailand and Malaysia home to the lion's share.



With no slowdown in sight, hotel owners are rushing to lock in their preferred hotel brand and operator, often before breaking ground. But with term commitments of up to 25 years, the modern hotel management arrangement is akin to (an ideal) marriage, and owners need to set aside romantic ideals, and — for posterity purposes — carefully review and negotiate the fine print before rushing to the altar. In doing so, they'll come across two seemingly innocuous but significant options for contractual designation of their betrothed: “agent” or “independent contractor.”

The chosen designation defines the relationship between the parties and, depending on the contract's governing law, plays a vital role in determining a host of legal issues, including liability, termination rights, damages and the purchase of goods and services from third-party suppliers. The agent vs. independent contractor debate has been hotly contested and adjudicated in the US; the same cannot yet be said for Asia. Accordingly, to understand the importance of this designation to Asia's budding hotel management landscape, it is necessary to look at how this designation has evolved in the US, since the modern management contract is often drafted from a US-centric perspective.

### **The evolution of the agent and independent contractor designations**

For years, operators preferred to self-designate as “agents” of the owner. As agents, operators were able to limit potential liability only to those acts committed *ultra vires* on behalf of the owner, as principal. This designation presented its own problems to operators because an agency relationship can usually be terminated by a principal at any time. It also gives rise to fiduciary duties

owed to the principal. Considering these two concerns, operators began self-designating as “independent contractors” who are providing a service to owners.

Concurrently, operators began expressly disclaiming an “agency” relationship and, correspondingly, its implied duties of loyalty, due care and diligence. In this way, operators sought to protect against any allegations of “self-dealing,” a worry for operators seeking to purchase goods and services on arguably less than an arm's length basis. In addition, operators expressly carved out limitations of liability owed to owners with the exception of acts committed *ultra vires*. Operators, through the courts, effectively transformed the contractual relationship norm to that of independent contractor, while creating market standard language for significantly disclaiming any liability and fiduciary duties owed to owners.

But whether “independent contractor” or “agent,” operators have been unable to compel specific performance of a hotel management agreement. Rather, courts across various US jurisdictions have almost universally held that a management contract is terminable at the will of the owner, even when unlawful, and that in such instances the operator's remedy is to seek damages. However, like everything in life, there are exceptions to the rule, and in the hotel management context, the most common exception is when the relationship is an “agency coupled with an interest.” In the hotel management context, such an agency would be most likely to arise when the operator manages the hotel and also has equity in the owning company or some other interest in property subject to the hotel management agreement. In these cases, the agency may be irrevocable.

*Owners are [...] recommended to be vigilant when negotiating the management agreement and clearly and expressly spell out any fiduciary duties that are owed.*

The relationship status between an owner and operator is complicated in the US and needs to be carefully considered against the backdrop of the relevant court precedents and governing laws. For example, the laws of the State of Maryland state provide that (i) when conflict exists between the express terms and conditions of a hotel management agreement and the terms and conditions implied by law governing an agency relationship, the express terms and conditions of the agreement prevail; and further that (ii) a court may grant specific performance, (ie, an injunction) for an anticipatory or actual breach or attempted or actual termination of a hotel management agreement. An owner would be well advised not to agree to Maryland law in its hotel management agreements as a result.

The question here is whether the designation of agent or independent contractor requires the same level of attention in hotel management agreements in Asia. The answer is yes.

### **The effect of this designation on the hotel management agreement in Asia**

We are not aware of any jurisdiction in Asia where the agent/independent contractor issue has been as hotly contested as in the US. However, this does not make the designation irrelevant. The opposite is true in fact, as with less court precedent to rely upon, courts of first instance are more inclined to look at the four corners of the contract in determining whether the operator is acting as agent or independent contractor, and consequently, how the designation impacts related issues in the contract, inter alia, fiduciary duties and termination rights.

By way of example, under Thai law, substance supersedes form, and Thai courts will look at the body of the hotel management agreement when assessing the nature of the relationship. Therefore, even if the contract dictates that the operator is an independent contractor and disclaims an “agency” relationship, if the owner exerts a certain degree of command and control over the operator and the management of the hotel, then the relationship is more likely to be deemed an agency relationship.

As an agent, the operator would owe certain duties to the owner under the law of Thailand, which — as a civil law country — has numerous principal-agency laws acknowledging certain features of fiduciary duties. By being a principal, the owner in turn would become liable to the third party for any acts which the operator, as the agent, performed within the scope of the authority. An owner is advised to negotiate operator indemnification provisions hard as a result.

In practice, most operators will have a great deal of independent control over the management of hotels in Thailand. This control will deem the relationship independent contractor in nature, regardless of what language in the agreement may state. Owners are therefore recommended to be vigilant when negotiating the management agreement and clearly and expressly spell out any fiduciary duties that are owed.

*(The above analysis is specific to Thailand, and a similar analysis would need to be undertaken for each Asian jurisdiction.)*





## Conclusion

The agent vs. independent contractor issue is more often negotiated in the West, but that does not mean it is less important to hotel management agreements in the East. In this ever more digital world, where privacy and cybersecurity are key concerns, and where operator consolidation is resulting in less and less attention to individual owners, there will be more and more examples of operators failing to act in owners' best interests, negligently, or in contravention of law. Owners across Asia need to consider carefully how their relationship to the operator is defined legally in order to know whether assertion of any contractual rights is better made against its agent or an independent contractor.

# Block leasing in Sweden — a growing trend

Jan Råssjö and Mats Eriksson, Stockholm

In the Swedish housing market, there has been an increasing trend for companies, municipalities and others subleasing dwellings to let to, for example, employees, students, asylum seekers and other groups. This is often done through block leasing. During the first six months of 2018, the Rent Tribunals (Sw. *Hyresnämnderna*) in Stockholm, Gothenburg and Malmö together received twice as many applications as they did in the first six months of 2016. This increase can be partly explained by the increased demand from asylum seekers. Another explanation is the general housing shortage in urban areas, which has resulted in more companies entering into block leasing agreements in order to offer accommodation to their employees. There has also been increased interest in what are known as long-stay hotels, that is, apartment hotels renting out rooms or apartments monthly or for a longer period of time.

So what is block leasing? Block leasing means that one landlord rents out a number of separate dwellings within the frame of one lease agreement, known as a “block,” instead of entering into a separate lease agreement for each dwelling. When entering into a block lease agreement, the presumption is that the provisions of the Rent Act (Sw. *hyreslagen*) regarding residential apartments

shall apply. The provisions of the Rent Act grants residential tenants particularly strong protection, but when entering into a block lease agreement, both landlord and tenant are allowed to make exceptions regarding some of these provisions (see below). However, in relation to the premises, the conditions of a block lease agreement may not conflict with the provisions stipulated in the Rent Act.

Consequently, since both landlord and tenant enjoy a higher degree of freedom of contract, a block lease agreement resembles a lease agreement over premises more than a lease agreement over dwellings.

A prerequisite when determining that block leasing, in accordance with the provisions of the Rent Act, is applicable is that the lease agreement covers at least three



*The block lease tenant may have to keep the apartments in better condition than the landlord has to.*

residential apartments, which the first tenant shall sublet individually or on a cooperative basis. If these prerequisites are met, the landlord and the first tenant shall agree on the conditions that conflict with the Rent Act's provisions for block lease agreements. The most common exceptions include:

- the condition of the apartments;
- maintenance of the apartments;
- determination of rent;
- indexation of rent; and
- terms of termination.

Regarding the condition and maintenance, it may be possible, depending on the nature of the apartment, to agree on a lower standard than that of the main principle of law governing residential apartments. Under the main principle, each apartment shall be fully fit for purpose, meaning that there is a lowest acceptable standard, and that standard depends on the standard of similar apartments in the same city.

However, it must be highlighted that the potential to agree on a lower standard only applies to agreements between the landlord and the block lease tenant. In the next step, that is, when the block lease tenant enter into agreements with each resident, the principle of the lowest acceptable standard applies, meaning that the block lease tenant may have to keep the apartments in better condition than the landlord has to. However, there has been no decisive case law in this area, and it is difficult to predict what will constitute "acceptable condition of the apartment" in relation to the main principle of lowest acceptable standard. The landlord should therefore exercise caution when applying this exception.

Regarding the maintenance of apartments, in a block lease agreement the landlord is able to transfer a bigger part of the responsibility to the block lease tenant. This possibility is mainly motivated by the fact that these apartments are often subject

to a higher degree of wear and tear, since tenants tend move in and out of these apartments more frequently, compared to typical residential apartments. Even in this case, for the benefit of the residents, the block lease tenant is obliged to meet the Rent Act's provisions regarding maintenance of the apartments.

The determination of rent on residential apartments is based on what is known as the utility value principle (Sw. *bruksvärdesprincipen*), according to which, apartments of an equal standard shall be subject to the same rent. In practice, when negotiating in accordance with this principle, the landlord negotiates with the tenant associations and the parties compare different housing objects with each other before they enter into an agreement regarding a suitable rent level based on the rent of the objects of comparison. Instead of having a fixed rent specified, in a block leasing agreement, which covers a term of more than three years, the landlord



may apply the Rent Act's provisions regarding other rent calculation methods. However, the presumption that rent should be determined in accordance with the utility value principle remains, whilst the landlord may charge a supplement for, for example, indexation of the rent and high levels of wear and tear to the apartment. Nevertheless, the rent calculation method must be stated clearly and accurately in the lease agreement, or the provision is invalid.

Finally, the parties often agree on a longer term of termination than three months, which is standard for lease agreements regarding residents.

It is a common misconception that the Rent Tribunal must accept all kinds of block leasing agreements. The decisions of the Rent Tribunal do not cover an entire block lease agreement as such. Instead, only the conditions the parties may have agreed on and that deviate from the Rent Act's provisions are subject to the Rent Tribunal's decisions. Accordingly, a landlord and a tenant may always enter into a block lease agreement, as long as the content of the agreement is not in conflict with the Rent Act's provisions regarding rent of residential objects. The Rent Tribunal's acceptance of the deviating conditions are not necessary when it comes to this kind of block lease agreement.

However, conditions that are in conflict with the Rent Act's provisions regarding residential apartments must be approved by the Rent Tribunal in order to be valid. Furthermore, before reaching a decision, the Rent Tribunal must consider whether there is a real need for the block leasing, which would motivate the exceptions from the regulations regarding residential apartments. The latter requirement does not follow from the wording in the Act itself, rather it follows from the preparatory work. In the preparatory work it is stated that "serious need" includes an educational institution's need to offer student housing or an employer's need to offer housing to its employees. Recent decisions from the Rent Tribunal make it clear that asylum housing

constitutes a serious need, since these premises are often leased through a block lease agreement with the state (normally through the migration Authority (Sw. *Migrationsverket*) as the block lease tenant.

Exceptions from the Rent Act's regulations regarding residential tenancy must be approved by the Rent Tribunal because the legislator wants to avoid a situation where less serious property owners try to circumvent the mandatory regulations governing residential leases.

However, it is not necessary to obtain the Rent Tribunal's approval if the landlord is the state, a municipality, a county council or a similar public entity. This latter provision is unclear since, when it comes to block leasing, the property owner and the block lease tenant are landlords. From the preparatory work though, it is apparent that the exception only applies when the state, etc. owns the property. Thus, if the state, etc. is tenant, the Rent Tribunal must approve conditions that are in conflict with the Rent Act.

There are examples of decisions where the Rent Tribunal has approved the complete block leasing agreement instead of just the conditions that are in conflict with the Rent Act. However, we recommend, when it comes to applying to the Rent Tribunal, that it is clearly stated for which conditions (ie, the exceptions from the residential lease provisions) the approval of the Rent Tribunal is being sought. Where the Rent Tribunal does not approve the exceptions, it is worth noting that there is no right of appeal. Finally, by way of warning, it should be noted that there is a risk that the tenants of the block lease tenant may request a customary review of the rent in accordance with the principle of utility value. If such a review proves that the tenant pays a higher rent than they would have done if the principle of utility value had been applied, a situation may arise where the block lease tenant subsidizes the rent of the resident, since the block lease tenant is unable to charge rent which corresponds to the amount paid to the property owner.

# Go big or go homes...

Hayley Russell-White and Jonathan Northey, London

The burgeoning UK build-to-rent (BTR) market has been more than just a topic of conversation for some time now. It is widely reported that the number of UK residents renting privately has doubled over the past decade due to a change in mindset in relation to home ownership and the rising cost and poor supply of new homes. Into this fast growing gap between social housing and home ownership, the BTR model has given property developers a lucrative opportunity and has attracted billions in investment, and it is forecast to grow further as the market matures and diversifies.

In this article we address the current state of the market and how we think we are now coming close to a split in the BTR sector between those trading/investing and those genuinely concentrating on building/developing.

The BTR model allows property investors to achieve consistent long-term investment returns as they have the capital to develop bespoke blocks of apartments, which can be let out and managed long term by a single company rather than being sold to individual landlords. However, until now there has been pretty much no built and trading portfolios of purpose-built BTR accommodation. This has led to many investors becoming reluctant developers.

We have also seen the benefit to tenants of this model, as it gives them more choice and offers better property management and security than those services currently offered

by small-scale landlords (often individuals). BTR is also attractive to the government and planning authorities as they see that it offers a way to generate long-term income for developers and investors whilst still meeting housing targets and needs. The units can be delivered faster than housing for sale because there is less risk of market saturation and bigger schemes are capable of being built, as can be seen at Wembley Park where Quintain is currently delivering 5,000 units as part of London's largest development.

Examples of those investing in BTR schemes have received much publicity in recent years, but the potential sale of the business (to include Tipi, the rented homes brand) of the Wembley Park development indicates that there is a real appetite for foreign investors in purchasing BTR units on a large scale, despite Lone Star's recent withdrawal from the sale.

The potential sale arose just as residential property in London came under pressure, with house prices falling at the end of 2017 for the first time since 2009. This was due to the uncertainty of Brexit and low pay increases and it was an almost unique opportunity to buy directly into a brand with an operational development business and enormous pipeline. Lone Star's decision to put Wembley on the market partway through development shows two things: that we are still not quite at the point of having constructed and stabilized stock at scale in the market and that foreign investment is very keen on buying big ticket BTR schemes.

Having schemes like Wembley on the market also demonstrates one of the noticeable trends from foreign investment over the last five years. Namely that London provides an opportunity for investors to pick up enormous single asset deals. This enables them to move



quickly into a new market and concentrate their efforts on one decision. This opportunity doesn't occur elsewhere, other than in a few markets in North America and the Far East (New York, Tokyo, etc.).

BTR is not only concentrated in London, as house prices are also increasing in the East and South East of England. Areas such as Cambridge are also facing major development constraints coupled with intense housing demand. Manchester, Liverpool and Bristol are also considered to be hotspots for rental-focused development.

Examples of those investors investing outside of London include Legal & General, which has set up a fund with Dutch pension fund PGGM with the potential for the fund to expand once initial developments are built. The fund will start with developments of a total of 650

homes in Bristol, Salford and Walthamstow. Gatehouse (a Kuwaiti-owned investment bank) has at least two BTR funds, with more than 1,600 homes having been built in projects worth a combined total of c. £250 million. The high-quality homes are in the Midlands and North West of England and are designed for family use.

It is fair to say that the funding pipeline is still evolving, but trends so far indicate that developers have largely followed a forward fund model where the developer builds the asset, but the investor lets and manages it. This can often lead to a discount to stabilized market value where the investor is taking some element of development risk and a blurring of the development and funding roles. Developers are keen to develop through to stabilization in the BTR sector where sites are viable, but they face challenges

with securing debt and persuading their boards to accept longer risk profiles. In addition to these long-term cash flow issues, it is also significant that when a BTR scheme is valued upon completion, it will generally be valued lower than an unencumbered identical property which can be sold on the open market. But as more stock starts to complete and trade, and confidence and data improves, it is likely we will move towards a new balance between development, investment and operational aspects. It is likely we will then finally see a clearer split between the development and investment markets, allowing an emergence of trading sales rather than forward funds. Wembley showed the appetite for structural changes within the market, but until shifts in funding and more assets become stabilized, we will still not see the clear demarcation seen in other asset classes.



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