



# Driving Factors & the Future of Real Estate Fund Structures

27<sup>th</sup> September 2017

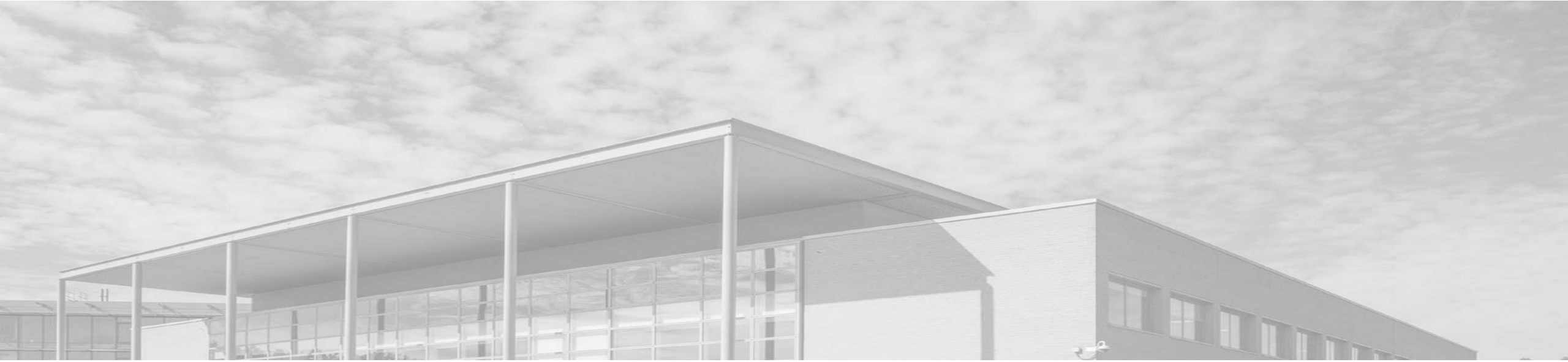


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**Welcome**  
**John Cartwright**  
**Chief Executive, AREF**

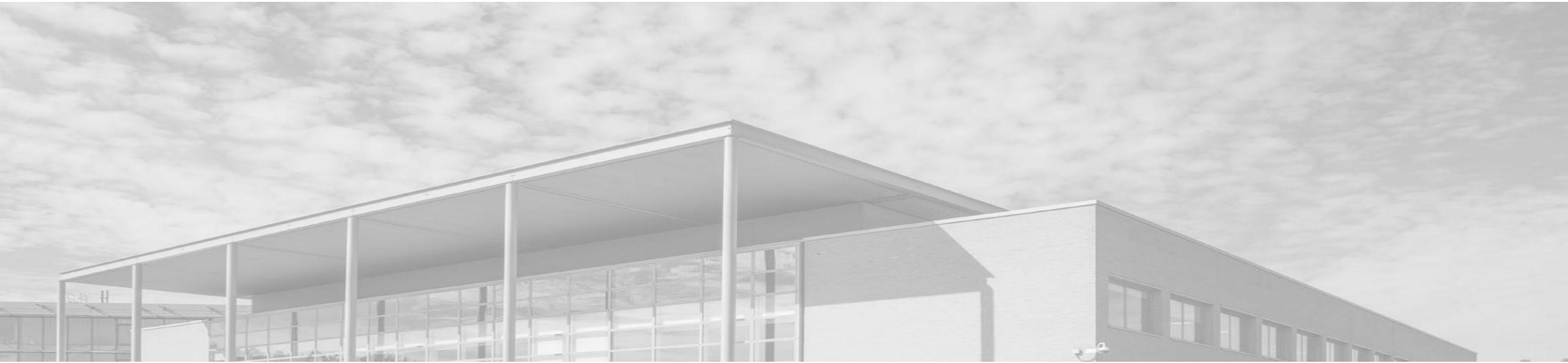


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## Chair

James Mulholland  
Partner, Carey Olsen



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# Speakers & Panellists



**Cathryn Vanderspar**  
Partner, Eversheds Sutherland



**Jonathan Master**  
Partner, Eversheds Sutherland



**James Mulholland**  
Partner, Carey Olsen



**Lisa McClure**  
Director, PwC



**Belinda Crosby**  
Head of Real Estate Investment Support  
Schroders



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# Agenda

- Presentation by Eversheds Sutherland
- Q&A Panel Discussion
- Networking



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# Driving Factors & the Future of Real Estate Fund Structures

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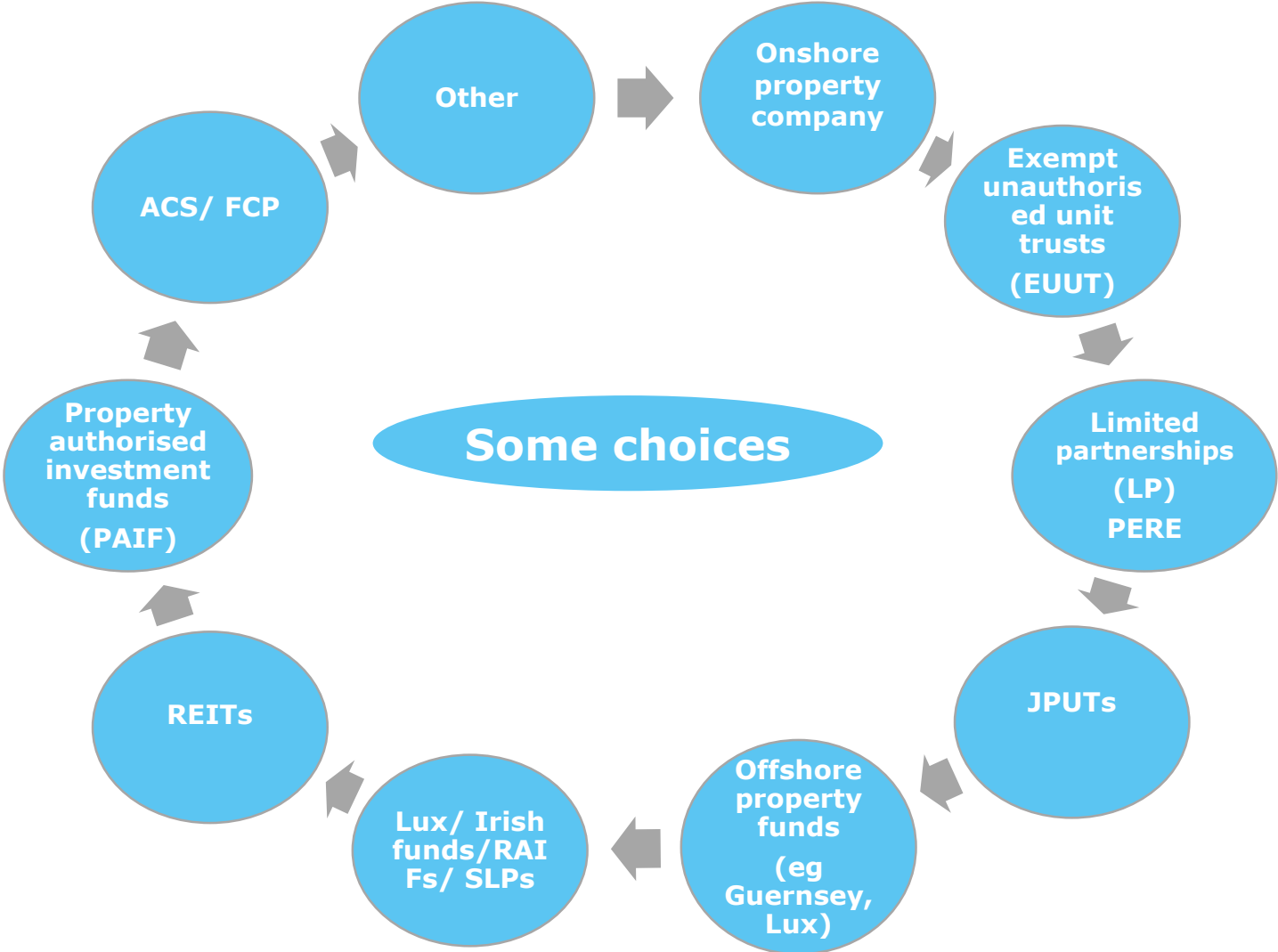
Jonathan Master,  
Cathryn Vanderspar,  
Partners



# Today's topics

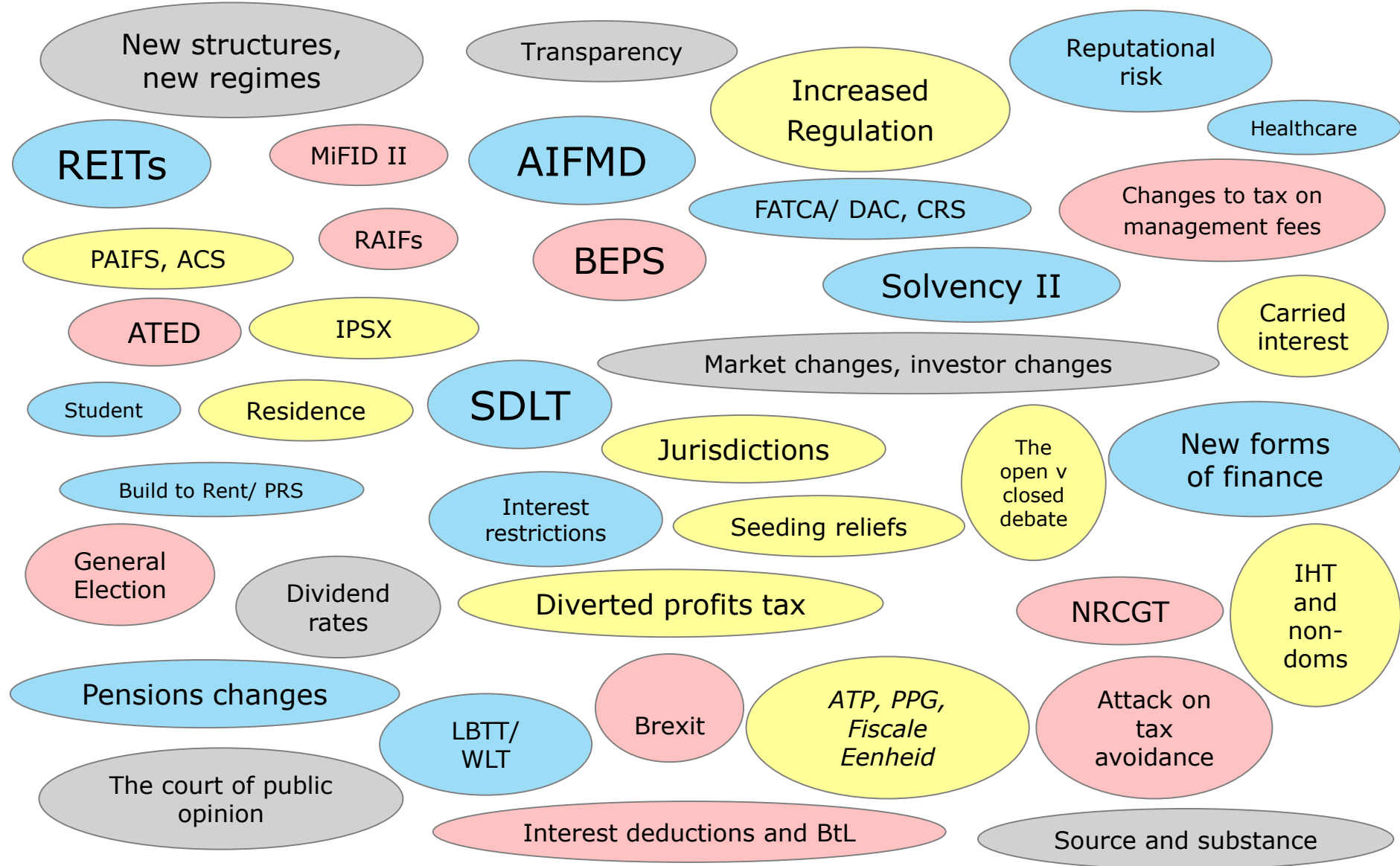
- **Setting the scene**
- **Regulatory developments**
- **Tax update**
- **Brexit**
- **Other market developments**
- **Panel discussion**

# Setting the scene: typical fund choices (for UK real estate)





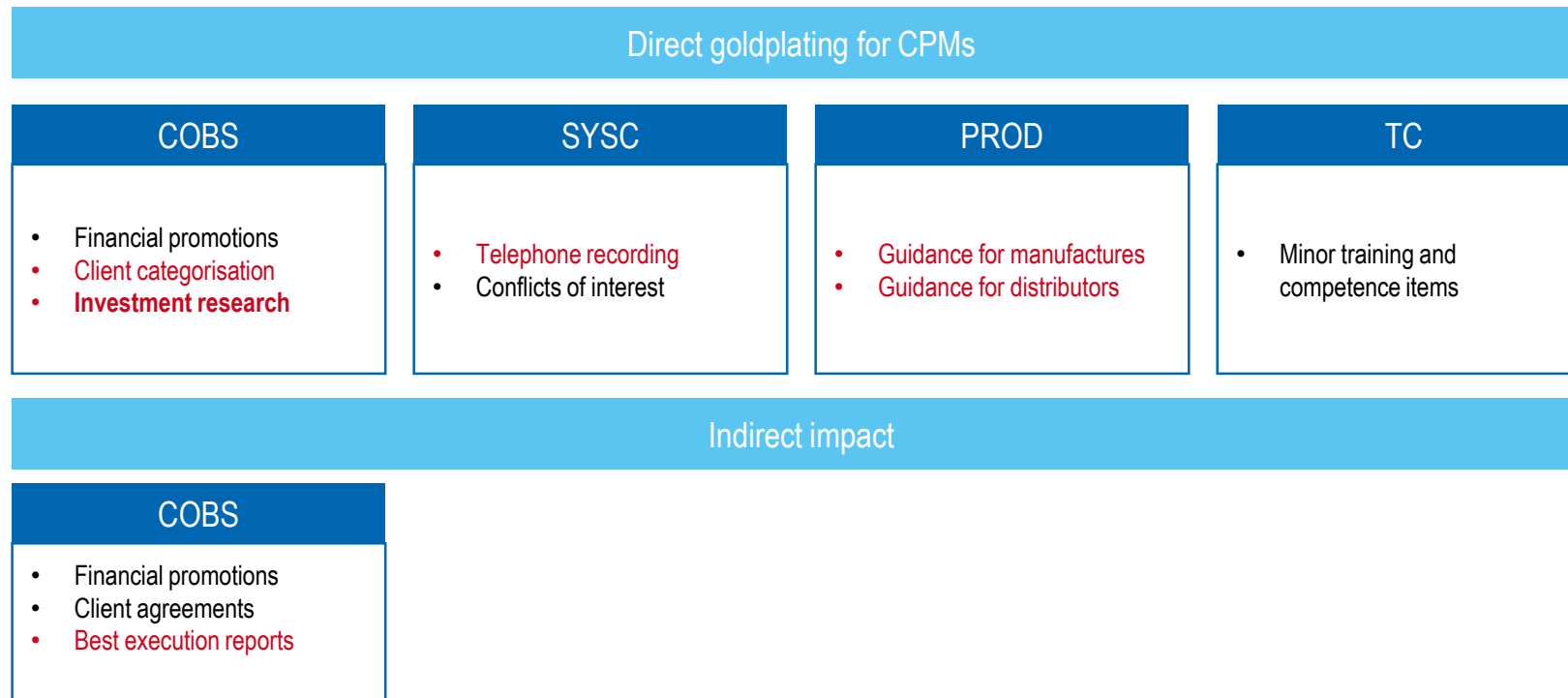
# Setting the scene: the changing world



# Regulatory developments

- **EMIR**
- **Benchmark Regulation**
- **Private fund limited partnerships**
- **MiFID II**
- **New IPSX**

# MiFID II Scope Application to CPMs including AIFMs



# MiFID II Distribution

- **Appropriateness**
- **Product governance**
- **Inducements**
- **Disclosures**

# Tax: UK developments

## So far:

Carried interest  
Hybrid mismatch rules  
Trading in land rules  
Property rich companies  
Residence: Case law: *Dev Sec*

## Resi:

Restriction on interest for BTL  
NRCGT  
Resi SDLT rates  
ATED

## New structures/developments:

PAIFs  
ACs  
REITs: "institutional investors"  
Competition: Lux SLPs, RAIFs etc

## What else is coming up?

IHT changes on resi for non-doms  
BEPS (see next)  
Interest restrictions and company NRLs?  
Brexit

# Base Erosion and Profit Shifting (BEPS)

Action	UK position
2: Neutralise the effects of hybrid mismatch arrangements	Implemented in the UK from 1 Jan 2017
4: Limit base erosion via interest deductions and other financial payments	To be implemented in the UK from 1 April 2017 for corporation tax payers  Consultation on extension to non-resident company landlords
5: Counter harmful tax practices, taking into account transparency and substance	UK task force to investigate land transactions
6: Prevent treaty abuse (including 'treaty shopping')	Redrafting of multilateral instrument to amend bilateral DTTs. 71 jurisdictions signed up so far (1100 treaties by 2018)
7: Prevent the artificial avoidance of PE status	UK changed law to ensure that development as a trade is subject to corporation tax: treaty changes
12: Disclosure of aggressive tax planning	UK already has DOTAS rules
13: Transfer pricing and Country-by-country reporting	In force from 1 Jan 2016. Jurisdictions to use info to decide whether to commence TP enquiries

# Corporate “interest” restriction

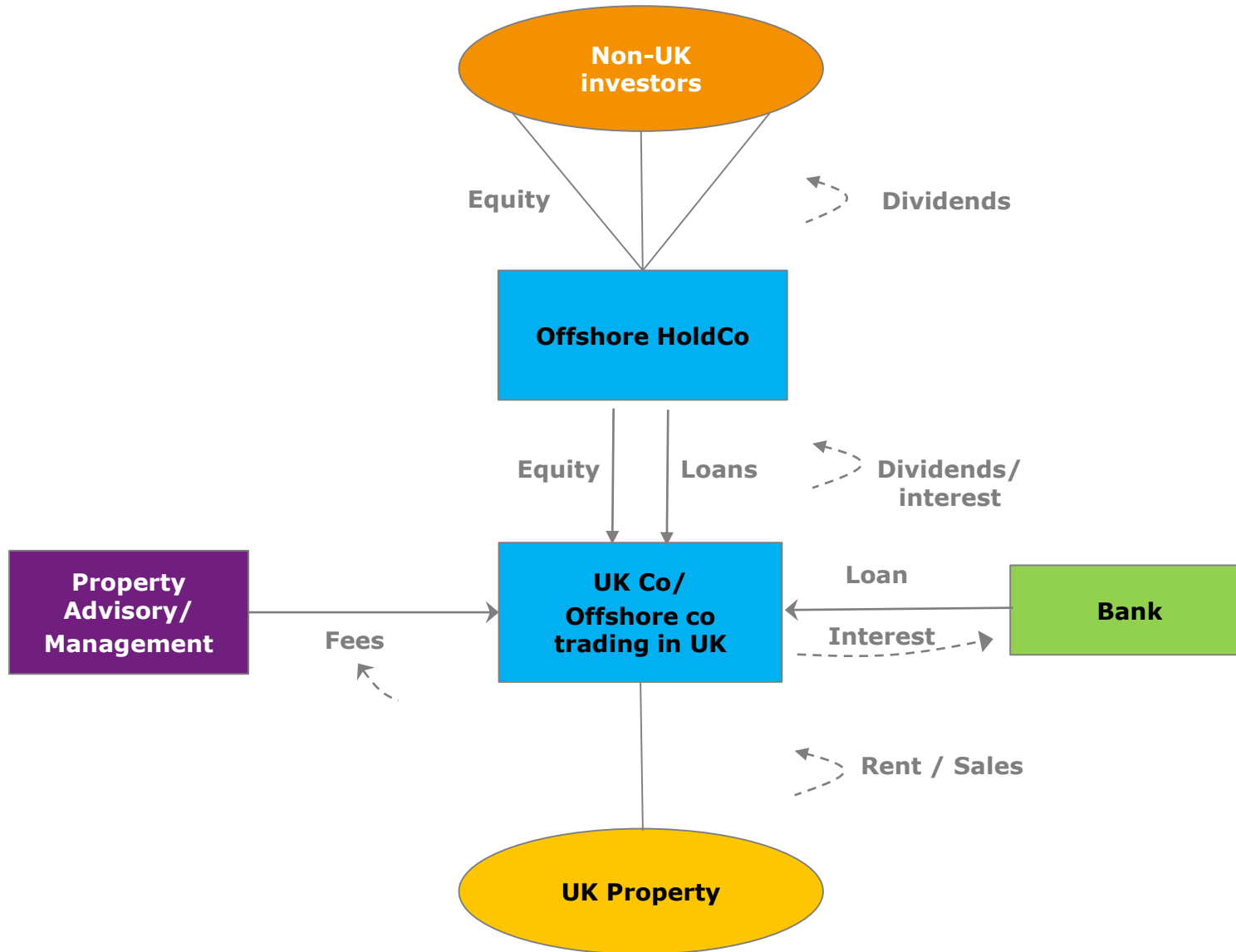
- Restriction on “interest” deduction on UK profits of world wide “group”
- Choices:
  - **Fixed ratio:** (default) lower of:
    - (1) 30% tax EBITDA: and
    - (2) adjusted net worldwide group interest expense
    - (related party debt not relevant)
  - **Group ratio:** (election): lower of:
    - (1) % qualifying net group-interest expense/ group EBITDA; and
    - (2) qualifying (worldwide) net group external interest expense
    - (excludes “related party debt”: very widely defined)
  - In each case: £2m floor per group
- **Public infrastructure alternative:** for qualifying companies on qualifying real estate letting activities
- Impact on returns, structuring, lending and M&A

# Fixed Ratio v Group Ratio v Public Infrastructure

Issue	Fixed Ratio	Group Ratio	Public Infrastructure
<b>Basic position</b>	<b>Greater of £2m and 30% tax-EBITDA (broadly follows tax rules)</b>	<b>Greater of £2m and % net interest to Group EBITDA (broadly follows financial statements, plus more adjustments and elections)</b>	<b>No restriction for qualifying interest in qualifying companies (QIC), but interest and EBITDA excluded from rest of group computations</b>
<b>Modified debt cap</b>	<b>Yes</b>	<b>Yes</b>	<b>No</b>
<b>Election required</b>	<b>No</b>	<b>Yes</b>	<b>Yes, lasts 5 years</b>
<b>Third party debt</b>	<b>30% tax-EBITDA</b>	<b>Potentially all deductible, but see below</b>	<b>Potentially, all deductible, but see below</b>
<b>Related party debt</b>	<b>No special rules</b>	<b>Ignored</b>	<b>Potentially deductible, if from QIC to QIC</b>
<b>Guarantees/ indemnities/ recourse relevant?</b>	<b>No</b>	<b>Yes</b>	<b>Yes</b>

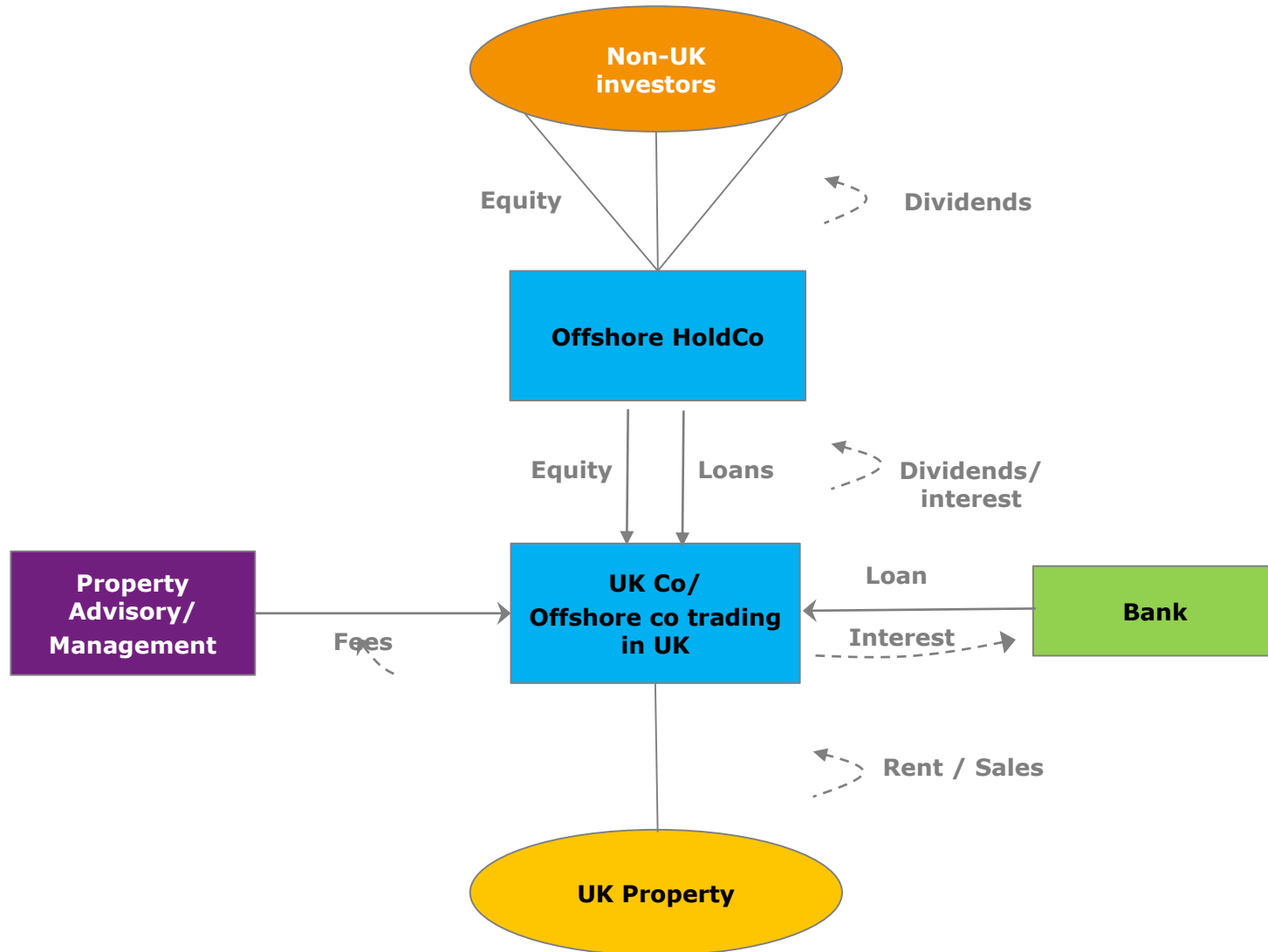


# UK company structure



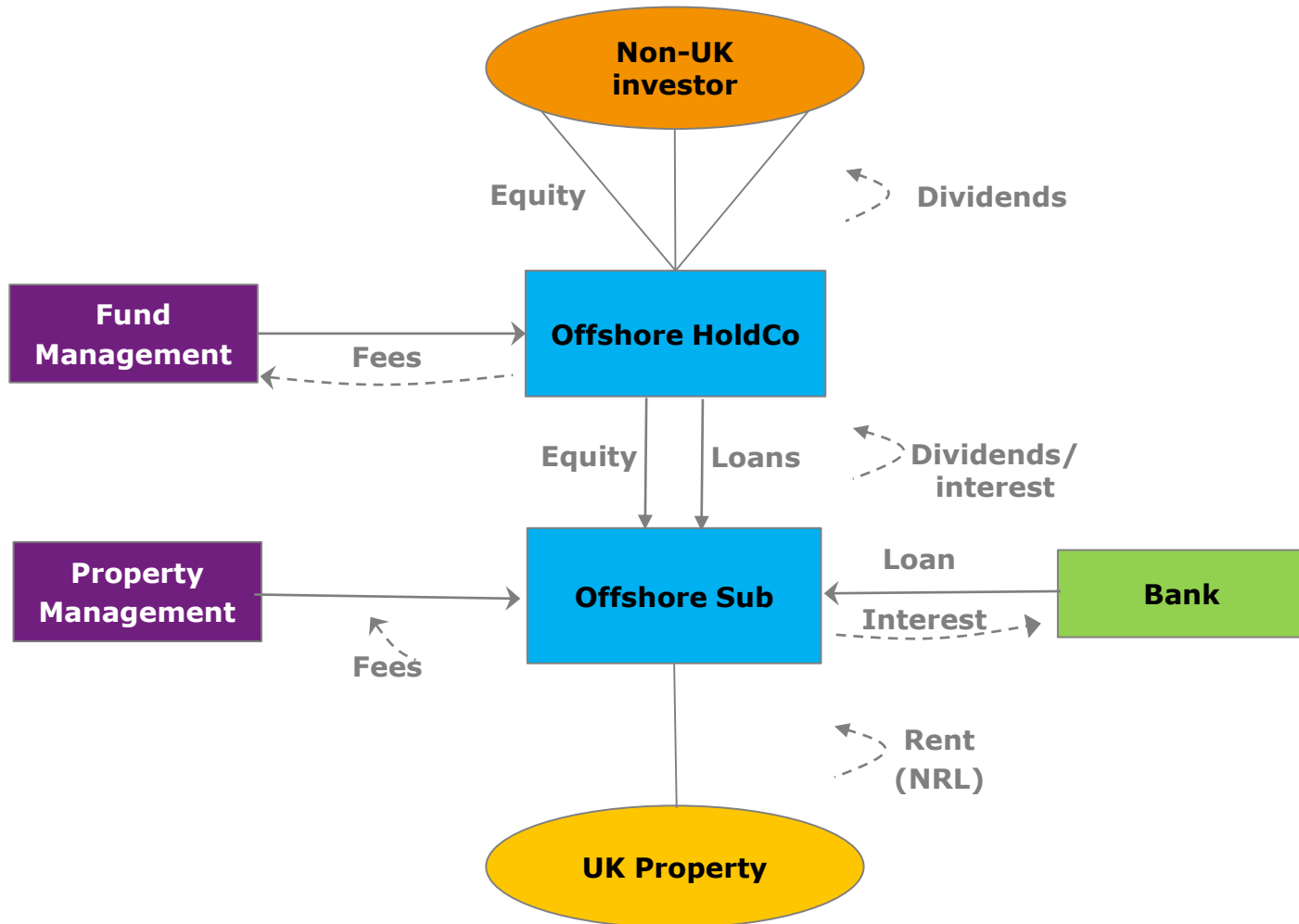
- **Assume loans are properly transfer priced**
- **Transactions in UK Land Rules?**
- **Property rich company rules?**
- **Hybrid mismatch rules potentially denying all related party interest**
- **Potential denial of interest deductions for UK CT payer**

# UK company structure



- **Assume loans are properly transfer priced**
- **Transactions in UK Land Rules?**
- **Property rich company rules?**
- **Hybrid mismatch rules potentially denying all related party interest**
- **Potential denial of interest deductions for UK CT payer**

# Offshore investment company structure



## Benefits

- Flexible
- Well known in UK
- Offshore situs asset for IHT (resi?)
- No SD/ SDLT on share transfers
- No tax on gains in fund
- Effective rate of income tax below 20% through deductions on (ia) loan interest
- Dividend returns for investors: no wht
- Potential portfolio exit without SDLT
- Potential liquidity through listing

## Issues

- Offshore management/ residence
- Determining the effective rate: allowable interest costs
- Cost and management of risk
- Some pension funds may not wish to invest in a non-UK structure
- Third country fund for AIFMD purposes
- **Transactions in UK land rules**
- **Property rich companies: is disposal taxable?**
- BEPS:
  - *reduction of interest deductions for company NRLs: economic impact. What is a "group"?*
  - hybrid mismatches
- IHT and resi
- UK onshore property structures (eg REITs, PAIFs, ACSs) address some of these issues
- Structuring re "group"

# Brexit

- **EU financial services rules and third countries**
- **The UK as a third country and impact on other third countries**

# Third Country Passport Rights?

<b>Financial Institution Type</b>	<b>EU Law Governing passport rights</b>	<b>Third Country Rights</b>
<b>Bank</b>	<b>Capital Requirements Directive IV</b>	<b>No</b>
<b>Bank, investment firm</b>	<b>Markets in Financial Instruments Directive</b>	<b>Yes limited to sophisticated clients</b>
<b>Bank, payment Institution</b>	<b>Payment Services Directive</b>	<b>No</b>
<b>Electronic money institution</b>	<b>Second Electronic Money Directive</b>	<b>No</b>
<b>Credit intermediary</b>	<b>Mortgage Credit Directive</b>	<b>No</b>
<b>UCITS management company</b>	<b>UCITS IV Directive</b>	<b>No</b>
<b>Alternative Investment Fund Manager</b>	<b>Alternative Investment Fund Managers Directive</b>	<b>Yes limited to sophisticated clients</b>
<b>Insurer and Reinsurer</b>	<b>Solvency II Directive</b>	<b>No</b>
<b>Insurance intermediary</b>	<b>Insurance Mediation Directive</b>	<b>No</b>

# What might an exit look like?

## Potential outcomes for UK firms



Increasing level of access

☆☆☆☆  
**Outcome 1**  
**'Lock-out'**

**UK firms' third country passport rights under certain Directives not recognised and UK not otherwise recognised as having an equivalent regulatory regime**

**e.g. like China under the AIFMD**

☆☆☆☆  
**Outcome 2**  
**3<sup>rd</sup> country access**

**UK firms' third country passport rights under certain Directives recognised but no EU single financial market passport rights**

**e.g. like the US under the AIFMD once third country passport 'turned on'**

☆☆☆☆  
**Outcome 3a**  
**Negotiated access**

**Either as a member of EFTA or not, UK negotiates a special arrangement with the EU. UK firms have no EU single financial market passport rights but a special UK passport**

**e.g. similar to Switzerland (for insurers) currently**

☆☆☆☆  
**Outcome 3b**  
**EEA Country**

**UK joins EEA and has access to single market. UK firms able to use EU passports but UK has limited ability to influence content of Directives and Regulations**

**e.g. like Norway currently**

# Market developments and looking forward: what does all this mean?

## Shifting sands

New law  
New structures  
New markets  
New asset classes  
New investors  
New investor appetite

Underlying assets/  
business plans are  
changing

Tripwires increase

## Innovation and change

Role of digital and  
technology

Substance and  
transparency

Move to simplicity?

Move to be more  
mainstream

The open v closed-ended  
debate

Change of the status quo

No one size fits all

Future proofing

Impact of "carry"  
changes on PERE –  
commercial  
ramifications

Impact of AIFMD

On-shoring: who, what,  
why?

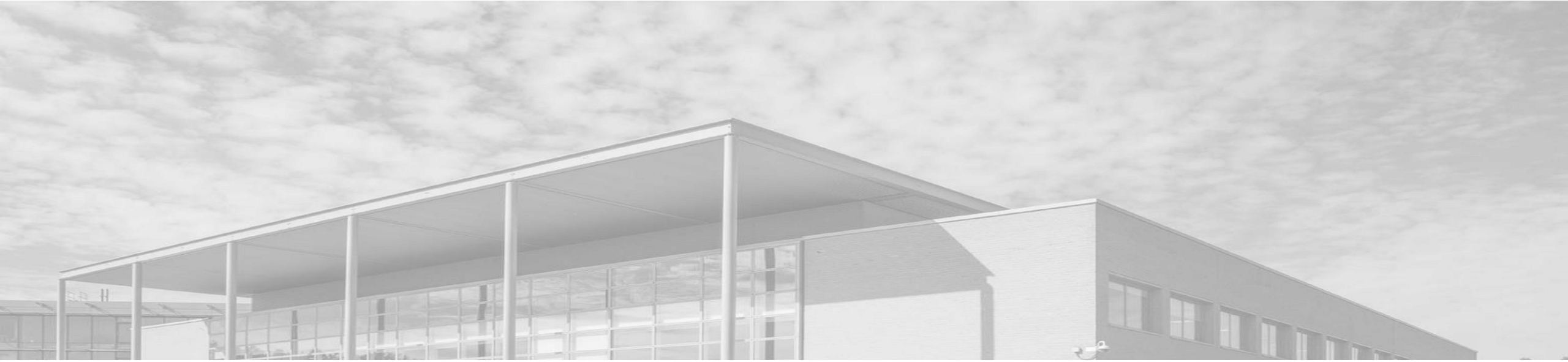
The impact for the CI?

Compliance

Protocols

Documentary changes

Costs



# Q&A

## Panel Discussion



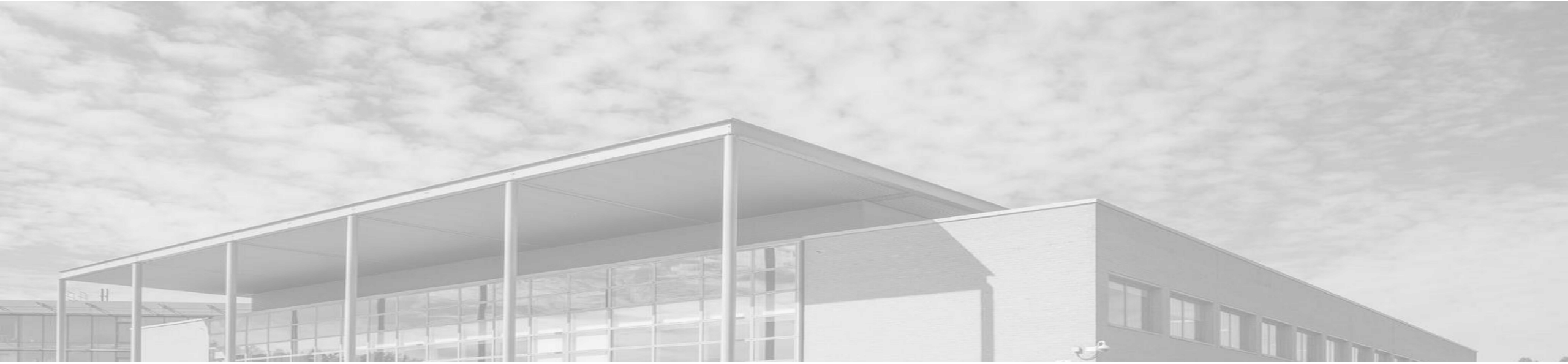
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# Thank you

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