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REAL ESTATE GAZETTE

FOCUS ON: REAL ESTATE FUNDS AND INVESTMENT VEHICLES

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KEY ISSUES FOR REAL ESTATE IN THE IMPLEMENTATION OF THE AIFMD ACROSS EUROPE

ASIA
UNDERSTANDING FOUR KEY CHANGES TO THE HONG KONG REIT CODE

MIDDLE EAST
EXPLORING FOREIGN INDIRECT INVESTMENT IN DUBAI'S REAL ESTATE MARKET

NORWAY
INTRODUCING FOREIGN REAL ESTATE AIFS IN NORWAY

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RIGHTS TO LIGHT—A NEW DAWN APPROACHING?

PROVIDING A SNAPSHOT OF THE EFFORTS OF NATIONAL GOVERNMENTS TO IMPLEMENT THE AIFMD

ISSUE 19

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A NOTE FROM **THE EDITOR**

The nineteenth issue of the DLA Piper Real Estate Gazette highlights issues relating to real estate funds and investment vehicles.

A very warm welcome to the first *Real Estate Gazette* of 2015.

The repercussions of the financial crisis of 2008 continue to resonate around the world. Of particular interest to readers of these pages is the resulting increase in regulations governing the activities of those involved in the investment market. As a major investment asset class, real estate is inevitably affected. One of the most significant legal developments in this area is the Alternative Investment Fund Managers Directive 2011/61/EU (AIFMD), which aims to establish uniform requirements governing the authorization, operations and supervision of AIF managers (which includes many managers of real estate funds), and to provide a rational approach to the related risks and their impact on investors and markets in the European Union. This issue provides a snapshot of the efforts of national governments to implement the new measures.

Following an international overview, and a comparative table, the rest of the articles in our focus section discuss a variety of issues relating to the AIFMD, and international investment generally, in individual jurisdictions. One of the themes underlying these articles is the continuing uncertainty that surrounds certain aspects of the AIFMD's implementation. In Belgium, for example, there is a lack of clarity around the pre-marketing rules applicable under the AIFMD (see page 20) whilst significant issues in the Netherlands are whether and, if so, how often, depositaries are required to carry out an independent asset verification (page 28), and whether or not the directive applies to Dutch REITs (see page 30).

DLA Piper's strength in looking at legal problems from all angles is apparent in the breadth of material covered in these articles. From pre-marketing activities to supervision of an AIF's continuing operations to whether indeed a market participant falls within the scope of the directive at all, it is clear that specialist legal advice is necessary to avoid the myriad potential breaches of the law in this area.

Other topics of interest in this issue include changes to FIRB approval of foreign investment in Australian real estate (page 37); new Italian legislation governing lending by insurers (page 40); the growing trend in Sweden to avoid stamp duty by using cadastral procedures to effect real estate transactions (page 45); and finally, the impact of rights to light issues on development schemes in England (page 49).

We do hope you will enjoy reading our views on these diverse issues, and if you would like to discuss any of the topics featured in this issue, please do get in touch. You can find contact details for all our contributors on the opposite page.

Olaf Schmidt, Head of International Real Estate

> "Continuing uncertainty surrounds aspects of the AIFMD's implementation"

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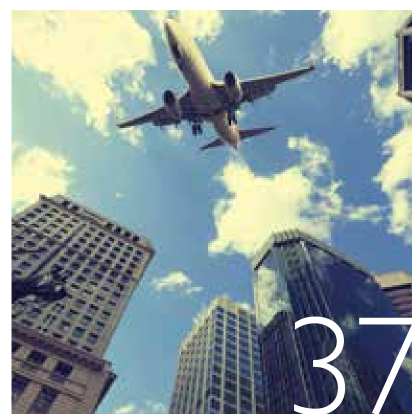

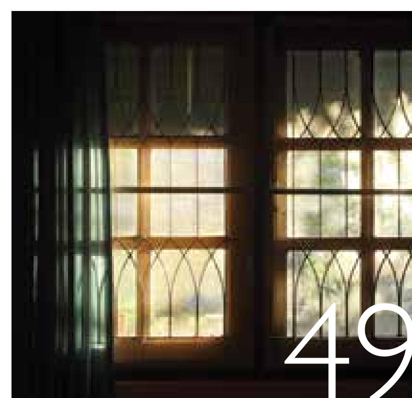

KEY ISSUES FOR REAL ESTATE IN THE IMPLEMENTATION OF THE AIFMD ACROSS EUROPE

CATHERINE POGORZELSKI, LUXEMBOURG AND
HENDRIK BENNEBROEK GRAVENHORST, AMSTERDAM

Introduction

Alternative investment fund managers (AIFMs) are responsible for the management of a large proportion of invested assets in the European Union and can exercise a significant influence on markets.

The impact of AIFMs on the markets in which they operate is largely beneficial, but recent financial difficulties have underlined how the activities of AIFMs may also serve to spread or amplify risks. Uncoordinated national responses make the efficient management of those risks difficult.

Since 22 July 2013, Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on AIFMs (AIFMD) requires managers of alternative investment funds (AIFs), including managers of real estate AIFs, to obtain authorization, meet ongoing operating conditions and comply with transparency and reporting requirements.

The AIFMD therefore aims at establishing common requirements governing the authorization and supervision of AIFMs in order to provide an internal market for AIF management, a coherent approach to the related risks and their impact on investors and markets, and a harmonized and stringent regulatory framework for the activities of all AIFMs within the EU, including those which have their registered office in a member state and those which have their registered office in a third country.

The authorization of EU AIFMs covers the management of EU AIFs established in the home member state of the AIFM. Subject to further notification requirements, this also includes marketing to professional investors within the EU of EU AIFs managed by the AIFMs and the management of EU AIFs established in member states other than the home member state of the AIFM. The AIFMD also provides for the conditions subject to which authorized EU AIFMs are entitled to market non-EU AIF to professional investors in the Union and the conditions subject to which a non-EU AIFM can obtain an authorization to manage EU AIFs and/or to market AIFs to professional investors in the Union with a "passport".

Each member state of the European Economic Area is adopting or has adopted legislation implementing the AIFMD into national law.

In the following pages we have invited DLA Piper's specialists to address some of the key questions that are relevant for AIFMs of real estate AIFs on a country by

> "The definition of 'marketing' does not include reverse solicitation or passive marketing."

country basis highlighting member states' gold standard provisions.

Glossary

"AIF" means alternative investment fund

"AIFM" means alternative investment fund manager

"AIFMD" means Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on AIFMs

"Carried interest" also known as a "promoted interest" (or, in the real estate industry, a "promote"), within the meaning of the AIFMD, means a share in the profits of the AIF accrued to the AIFM as compensation for the management of the AIF and excluding any share in the profits of the AIF accrued to the AIFM as a return on any investment into the AIF by the AIFM

"ESMA" means the European Securities and Markets Authority

"Level 2 measures" means the Commission delegated regulation (EU) No 231/2013 of 19 December 2012 supplementing the AIFMD

"Marketing", within the meaning of the AIFMD, means a direct or indirect offering or placement of units or shares in an AIF that an AIFM manages, at the initiative of the AIFM or on its behalf, to or with investors domiciled or with a registered office in the EU. It is worth noting that this does not include reverse solicitation or passive marketing, which consists of a request for information or investment made at the initiative of the investor itself

"NAV" means net asset value

"Private placement" usually defined, with respect to marketing, is the opposite of a public offering. There is no harmonized definition or governance framework, for such placements in the European Union or outside

"Sub-threshold AIFM" means a small AIFM benefiting from the *de minimis* exemption available under article 3(2) (a) or 3(2) (b) of the AIFMD and which is therefore only required to comply with the AIFMD (and its specific member state's implementing law) in respect of the registration and reporting obligations but does not benefit from the marketing passport

"UCITS Directive" means the Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), as amended

BELGIUM

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GENERAL TOPIC	QUESTIONS	
Scope	Has the AIFMD been implemented in your country? If so, when?	The AIFMD was implemented in Belgium by the Law of 19 April 2014 (the AIFM Law) which came into force on 27 June 2014. Execution decrees have not yet been issued.
	Is there a distinction between or carve-out from the AIFMD for REITs, real estate investment funds (REIFs), real estate holding companies or similar structures in your country?	The existing REIFs (known as "*sicafi*"/ "*vastgoedbevak*") qualify as alternative investment funds within the scope of the AIFM Law. However, as it was argued that the AIF framework did not provide any added value for REIFs and did not correspond to the economic reality, a new vehicle was introduced in Belgium with the Law of 12 May 2014 on Regulated Real Estate Companies (known as "*gereglementeerde vastgoedvennootschappen*"/ "*sociétés immobilières réglementées*"), in addition to the existing legal framework. Regulated real estate companies are still subject to the supervision by the Financial Services and Markets Authority (FSMA), are subject to leverage and risk diversification restrictions and distribution requirements, and benefit from the same tax status as REIFs. The former REIF regime remains in place and is governed by the AIFM Law, the Law of 3 August 2012 on collective investment undertakings and the Royal Decree of 7 December 2010 on real estate investment companies. In practice, all REIFs have opted for the new status of regulated real estate company, meaning that they fall outside the scope of the AIFM Law.
Valuation	How have the valuation rules and standards been implemented in respect of alternative real estate funds?	The rules on valuation in the AIFM Law are in line with the rules on valuation in the AIFMD. The valuation may be performed by an AIFM or by an external valuer. In addition to several general requirements, specific rules apply to valuations performed by an external valuer. Furthermore, the AIFM Law contains specific rules on the AIFM's liability in connection with the valuation of assets. Supervision is conducted by the FSMA.
Remuneration	Is promote/carried interest typically or specifically picked up in the variable part or is it treated otherwise?	Belgian law does not provide for a specific rule which classifies carried interest as variable remuneration. The FSMA specifically refers to the ESMA guidelines on sound remuneration policies under the AIFMD in its Circular FSMA_2014_10 dd.29/09/2014 and interprets any provisions on remuneration in the AIFM Law in line with such guidelines. Reference should be made to the ESMA Guidelines and in particular paragraphs 11 and 13.
Depositary	Has your country implemented the option to permit non-banking institutions to perform the depositary functions in respect of real asset AIFs?	Yes. The AIFM Law provides for a Royal Decree to allow non-banking institutions to perform depositary functions. The Decree has not yet been published but it could allow AIFs with no redemption rights exercisable during the first five years and whose core investment policy is not to invest in assets that must be held on deposit or to invest in issuers or non-listed companies in order to acquire those companies, to appoint a depositary in relation to a Belgian AIF, which is not a credit institution or an investment firm. If the AIF is established in another member state, the depositary may be an entity, registered under the terms of its national legislation, which carries out depositary functions as part of its professional or business activities. It must also provide sufficient financial and professional guarantees to enable it to perform its depositary functions effectively. For non-EU AIFs only, the depositary may also be a credit institution or any other entity of the same nature as a credit institution or an investment firm provided that the depositary is subject to effective prudential regulation, including minimum capital requirements, and supervisory rules which have the same effect as EU law and are effectively enforced.
Marketing	Did your country uphold its private placement regime in respect of EU AIFs managed by sub-threshold EU AIFMs and non-EU AIFMs; as well as non-EU AIFs?	Yes, the *de minimis* regime provided for in article 3(2) of the AIFMD is available for all Belgian AIFMs, irrespective of whether they relate to EU or non-EU AIFs.

See page 20 of this issue for a detailed look at Belgium's pre-marketing rules under the AIFMD.

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GENERAL TOPIC	QUESTIONS	
Scope	Has the AIFMD been implemented in your country? If so, when?	The AIFMD was implemented by the Danish Alternative Investment Fund Managers Act of 22 June 2013 (AIFMA) and delegated regulations. The AIFMA provided for a grace period of 12 months and by 22 July 2014 all parties subject to the AIFMA were required to comply fully with the AIFMA.
	Is there a distinction between or carve-out from the AIFMD for REITs, real estate investment funds (REIFs), real estate holding companies or similar structures in your country?	The definition of an AIF in the AIFMA follows that given in the AIFMD and there is no statutory exemption from the AIFMA for REIFs or similar entities. However, an entity whose purpose is to implement a commercial business strategy will not be classified as an AIF but as a commercial business, if the commercial activity of the entity is to i) purchase, sell or exchange goods or commodities or providing non-financial services, or ii) the entity primarily performs an industrial activity, which entails production of goods or construction of buildings. According to FSA guidance, if the primary activities and the administration of the real estate entity are focused on operating real estate, including administration, rent collection and property maintenance, that entity will not be subject to the AIFMA. If, however, the activities of the real estate entity are primarily focused on investing in and developing real estate, that entity will be subject to the AIFMA. Moreover, construction companies and developers who, for a shorter or longer period of time, hold real estate on their (group) balance sheets with the intent to sell it at a later time, will not be subject to the AIFMA.
Valuation	How have the valuation rules and standards been implemented in respect of alternative real estate funds?	Denmark applies the general rules for all funds laid down in the AIFMD regarding valuation performed by alternative real estate funds. An AIFM must establish appropriate procedures for the proper, consistent and independent valuation of each AIF's assets (including real estate funds). Valuation of assets must be performed at least once a year. This can be performed by either the manager itself or by an external valuer, although the FSA must be informed when external valuers are used, and any external valuer used must be professionally qualified, competent, and his appointment must comply with the requirements of the AIFMA. The external valuer must be independent of the AIF, its manager, and any other parties closely linked to the AIF.
Remuneration	Is promote/carried interest typically or specifically picked up in the variable part or is it treated otherwise?	Carried interest is generally classified as variable remuneration under the AIFMA and subject to the restrictions on variable remuneration. However, the AIFMA provides for certain exemptions, where: • the AIF has repaid the invested capital to investors and an amount equal to the predetermined rate of return of the invested capital prior to payment of carried interest to management members or other employees whose activities have a material impact on the manager's risk profile or the risk profile of the AIFs (key employees), and the carried interest is subject to claw-back until the liquidation of the relevant AIF; or • the AIFs invest in assets with a long investment horizon and predictable cash flows (including real estate), and the carried interest is paid to management members or key employees prior to the repayment of the investors including an amount equivalent to the predetermined rate of return on the invested capital. It must be unambiguously established at the time of payment of the carried interest that the funds available allow for refund of the invested capital as well as the predetermined rate of return to the investors within an agreed time frame, and that the carried interest is subject to claw-back until the liquation of the relevant fund.
Depositary	Has your country implemented the option to permit non-banking institutions to perform the depositary functions in respect of real asset AIFs?	Yes. Non-banking entities that perform depositary functions as a part of their professional or commercial activities and are subject to registration by law for such activities can perform depositary functions for AIFs which i) in accordance with their investment policy do not primarily invest in assets which are held on deposit and where the investors cannot redeem its shares or units of the AIF within the first five years; or ii) which primarily invest in non-listed companies with the aim of acquiring a controlling interest in those companies. Non-banking entities that intend to perform depositary functions must be able to provide sufficient financial and professional guaranties in order to secure effective performance of their depositary functions. Moreover, these entities must have liability insurance (to cover an amount of at least EUR 730,000. The FSA has established a registry of such depositary entities.
Marketing	Did your country uphold its private placement regime in respect of EU AIFs managed by sub-threshold EU AIFMs and non-EU AIFMs; as well as non-EU AIFs?	Sub-threshold EU AIFMs cannot currently market units or shares of AIFs in Denmark. Both EU AIFMs and non-EU AIFMs can apply for specific authorization to market units or shares of non-EU AIFs in Denmark to professional investors. Non-EU AIFMs can apply for authorization to market units or shares of EU AIFs in Denmark to professional investors, provided that they have a permit to manage those EU AIFs in an EU/EEA member state.

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GENERAL TOPIC	QUESTIONS	
Scope	Has the AIFMD been implemented in your country? If so, when?	The AIFMD was implemented in France by an ordinance (*ordonnance*) and a decree (*décret*) both dated 25 July 2013 amending the legal framework applicable to asset management. In addition, the General Regulations of the French Financial Markets Authority (AMF) have been amended. The new legal framework came into force on 22 July 2014.
	Is there a distinction between or carve-out from the AIFMD for REITs, real estate investment funds (REIFs), real estate holding companies or similar structures in your country?	Under French law, there is no specific distinction or carve-out from the AIFMD for REITs, REIFs, or similar structures. These structures would in principle be subject to the rules implementing the AIFMD provided the relevant criteria are met. Cases are assessed on an individual basis.
Valuation	How have the valuation rules and standards been implemented in respect of alternative real estate funds?	The valuation rules set out in the AIFMD have been implemented in France. No specific additional obligations have been provided in respect of real estate funds. The AIFM must ensure that the valuation of the AIF's assets is performed impartially and with all due skill, care and diligence. The AIFM is responsible for the accurate valuation of the AIF's assets, as well the calculation and publication of the asset value per unit/share. The AIFM must ensure that the assets of any AIF it manages are valued at least once or twice a year, depending on the nature of the investment vehicle. The AIFM may perform the valuation function itself or delegate this task to a third party expert. If the AIFM carries out this function itself, it must ensure that the valuation function is independent from portfolio management and that no conflict of interest arises. The rules are more flexible for sub-threshold AIFMs. If the AIFM appoints an external valuer, the external valuer must be approved by the AMF (if the AIFM is French) and be an independent expert. The AIFM remains liable for the valuation of the assets even where a third party expert was appointed.
Remuneration	Is promote/carried interest typically or specifically picked up in the variable part or is it treated otherwise?	Carried interest is specifically included in the more general provisions on remuneration that are targeted by AIFM rules in France. Therefore, principles of proportionality, deferred payments, etc. are expressly applied to carried interest. Further, depending on the AIFM's size, a remuneration committee may have to be appointed. It should be noted that France has a specific pre-AIFMD regime applicable to carried interest, that remains applicable in order for the AIFM to benefit from tax rebates.
Depositary	Has your country implemented the option to permit non-banking institutions to perform the depositary functions in respect of real asset AIFs?	France allows a limited number of non-banking institutions to act as depositaries, as follows: • credit institutions; • investment firms authorized to provide safekeeping and administration of financial instruments services; • insurance companies; • branches of EU-based credit institutions or investment firms authorized in their home country to provide depositary services; • other French public entities (*Banque de France, Caisse des dépôts et consignations*).
Marketing	Did your country uphold its private placement regime in respect of EU AIFs managed by sub-threshold EU AIFMs and non-EU AIFMs; as well as non-EU AIFs?	There is no specific private placement regime available for sub-threshold EU AIFMs and non-EU AIFMs in France. Therefore, they have to be authorized by the AMF before they can market shares of an AIF in France.

See page 22 of this issue for a discussion of how the implementation of the AIFMD has impacted French real estate collective investment vehicles (OPCIs).

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GENERAL TOPIC	QUESTIONS	
Scope	Has the AIFMD been implemented in your country? If so, when?	Implementation in Italy is still ongoing. The Unified Financial Act was amended on 4 March 2014. Further, the draft regulations from the Ministry of Finance have been put out for public consultation and the final version should be issued in early 2015. The regulations drafted by the Bank of Italy and Consob have been published and will come into force after the Ministry of Finance has issued its own regulations. All those falling within the scope of the AIFMD implementation must comply with the new regime by 30 April 2015.
	Is there a distinction between or carve-out from the AIFMD for REITs, real estate investment funds (REIFs), real estate holding companies or similar structures in your country?	REIFs are categorized as AIFs. The Italian entities which are most similar to REITs are the SIIQ (*società di investimento immobiliare quotata*, or listed real estate investment company) and the SIINQ (*società di investimento immobiliare non quotata*, or unlisted real estate investment company). Neither of these qualifies as an AIF. The main characteristics of an SIIQ are: (i) it is listed on a regulated market and subject to supervision by Consob; (ii) if listed on the MTA/Expandi markets, it must have share capital of at least EUR 40 million; (iii) no shareholder can hold shares representing more than 60% of the voting rights and more than 60% of the dividend rights; (iv) at least 25% of the shares of an SIIQ must be owned by shareholders who each own no more than 2% of the voting rights or more than 2% of the dividend rights; (v) it must be involved mainly in the leasing of real estate (real estate rented to third parties must represent at least 80% of its assets and the income deriving from rentals must represent at least 80% of its total income); and (vi) at least 80% of an SIIQ's net profit deriving from rentals must be distributed to shareholders. Real estate holding companies qualify as AIFs if their primary purpose is the investment of assets, collected through the issue of their shares (or other equity instruments) to a number of investors, managed as a whole in the interest of their investors and independently from them, mainly in real estate on the basis of a predetermined investment policy. Certain exceptions are provided.
Valuation	How have the valuation rules and standards been implemented in respect of alternative real estate funds?	Italian laws and regulations, even before the implementation of the AIFMD, provided detailed rules for the valuation of assets of real estate AIFs. The AIFM must establish appropriate and consistent procedures for the proper and independent valuation of the assets of real estate funds. Valuation must be performed by an expert independent valuer who is competent to carry out that role. The AIFM is responsible for the valuation, especially when, as it is empowered to do, it deems that the valuation carried out by the external valuer is not in line with the real value of the assets. Additional rules may be imposed by the secondary regulations that have yet to come into force.
Remuneration	Is promote/carried interest typically or specifically picked up in the variable part or is it treated otherwise?	Secondary regulations are yet to come into force, however ESMA Guidelines on fair remuneration policies under the AIFMD are directly applicable. Promote/carried interest are included in the variable part according to the remuneration rules.
Depositary	Has your country implemented the option to permit non-banking institutions to perform the depositary functions in respect of real asset AIFs?	Yes, the depositary may be an Italian bank, the Italian branch of an EU bank, an Italian investment company or the Italian branch of an investment company.
Marketing	Did your country uphold its private placement regime in respect of EU AIFs managed by sub-threshold EU AIFMs and non-EU AIFMs; as well as non-EU AIFs?	Sub-threshold AIFMs, whether Italian, EU or non-EU, do not benefit from a different set of rules in the area of marketing and the offering of units/shares of the relevant AIFs (again whether they are Italian, EU or non-EU).

LUXEMBOURG

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GENERAL TOPIC	QUESTIONS	
Scope	Has the AIFMD been implemented in your country? If so, when?	The AIFMD has been implemented in Luxembourg by the Law dated 12 July 2013 on alternative investment fund managers (which we will call the AIFM Law). Luxembourg's regulator, the *Commission de Surveillance du Secteur Financier* (CSSF), has issued a Frequently Asked Questions document in respect of the AIFM Law, the latest version of which was published on 29 December 2014.
	Is there a distinction between or carve-out from the AIFMD for REITs, real estate investment funds (REIFs), real estate holding companies or similar structures in your country?	Luxembourg has not implemented any specific regime for real estate fund platforms or real estate fund managers which will be treated as AIF and AIFM to the extent that the relevant criteria laid down in the AIFM Law are met. The definition of an "AIF" given in the AIFM Law covers AIFs which are established in Luxembourg, or in another EU member state, or in a third country, irrespective of the asset class involved. An AIF is any collective investment vehicle which, under article 1(39) of the AIFM Law (in the case of a Luxembourg-based AIF) or under article 4(1)(a) of the AIFMD (in the case of an AIF established in another EU member state or in a third country) (i) raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and (ii) does not require authorization pursuant to article 2(1) of the Law of 2010, respectively article 5 of the UCITS Directive). It is up to each collective investment vehicle to determine whether or not it falls within the definition of an AIF, as provided by the AIFM Law. The guidelines on key concepts of the AIFMD and the FAQs issued by ESMA are to be taken into account in assessing whether the criteria are met.
Valuation	How have the valuation rules and standards been implemented in respect of alternative real estate funds?	Luxembourg has not implemented any specific provisions on valuation other than those provided by the AIFM Law, and refers to Level 2 Measures to supplement those rules. Valuations of real estate assets is to be performed either by: • An independent and suitably qualified external valuer (who must hold a professional registration), whose appointment must be notified to the CSSF. Delegation of the valuation function to a third party is limited; or • The AIFM itself (provided the function is independent of portfolio management and policies are put in place to avoid potential conflicts of interest). The CSSF has the authority to require any such AIFM to have its valuation procedures and/or the valuations themselves verified by an external valuer or an independent auditor. In practice, most AIFMs do keep the valuation function in-house, and use external valuations as merely one source, along with an internal valuation, to determine the value of their real estate assets. In these circumstances, the valuation remains internal, and external valuers will not be subject to the special liability regime provided for under the AIFM Law. In addition it is worth noting, that under the AIFM Law, the rules applicable to the valuation of assets and the calculation of the NAV are subject to the law of the country where the AIF is established and/or in the AIF management regulations or incorporation documents. In other words, Luxembourg has not imposed any valuation rules, allowing the AIFM to follow accepted valuation standards.
Remuneration	Is promote/carried interest typically or specifically picked up in the variable part or is it treated otherwise?	Luxembourg did not apply any gold-plating to the remuneration rules set out in the AIFMD. Hence, the ESMA guidelines on fair remuneration policies are taken into consideration. Promote and carried interest are per se variable and deferred as long as they do not represent a pro rata return on an investment by the relevant staff members (directly or through a carried interest vehicle) meaning that the variable remuneration should partly be paid upfront (short-term) and partly deferred (long-term). It is worth noting that the AIFM Law allows an AIFM to disapply certain requirements in light of the proportionality principle allowing adequate consideration of the size, internal administration and nature, scope and complexity of the activities of the AIFM.
Depositary	Has your country implemented the option to permit non-banking institutions to perform the depositary functions in respect of real asset AIFs?	Yes. The depositary may be (i) a credit institution, (ii) an investment firm within the meaning of the amended Law of 5 April 1993 on the financial sector, or (iii) for AIFs established in Luxembourg, which, in accordance with their investment policy do not primarily invest in assets which are held on deposit and where the investors cannot redeem shares or units of the AIF within the first five years; or which primarily invest in non-listed companies with the aim of acquiring a controlling interest in those companies, the depositary may also be an entity which has the status of a professional depositary of assets other than financial instruments within the meaning of article 26-1 of the amended Law of 5 April 1993 on the financial sector. In other words, closed-ended real assets AIFs will be entitled to benefit from this option (as opposed to open-ended AIFs).
Marketing	Did your country uphold its private placement regime in respect of EU AIFs managed by sub-threshold EU AIFMs and non-EU AIFMs; as well as non-EU AIFs?	Yes. Luxembourg private placement rules applicable before the coming into force of the AIFM Law continue to apply with respect to sub-threshold EU AIFMs managing EU AIFs subject to compliance with the existing requirements. Certain new requirements apply to sub-threshold non-EU AIFMs and sub-threshold EU AIFMs managing non-EU AIFs. From 2013 until July 2015, non-EU AIFs and EU AIFs managed by non-EU AIFMs may continue to be marketed in Luxembourg under the national private placement regime subject to compliance with certain additional conditions as set out in the AIFM Law. From July 2015 until 2018, the passport regime will co-exist with the private placement regime. Thereafter, the private placement regime is expected to be replaced entirely by the passport regime. In addition it is worth noting that subject to compliance with domestic private placement rules, marketing to retail investors in Luxembourg is permitted provided that the AIF is subject to permanent supervision by either the CSSF or the supervisory authority of the home member state or a third country considered to provide an equivalent standard of supervision as that of the CSSF. For non-regulated Luxembourg AIFs, marketing in Luxembourg may only be directed to professional investors.

NETHERLANDS

CONTACT

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GENERAL TOPIC	QUESTIONS	
Scope	Has the AIFMD been implemented in your country? If so, when?	The AIFMD was implemented by the Dutch Financial Supervisions Act (FSA) and delegated regulations were promulgated on 22 July 2013. From that date a year of transition commenced during which all market parties had to assess whether or not they fall within the scope of the AIFMD. As of 22 July 2014 all parties which are governed by the AIFMD must comply with the new regime.
	Is there a distinction between or carve-out from the AIFMD for REITs, real estate investment funds (REIFs), real estate holding companies or similar structures in your country?	The definition of a Dutch REIT incorporates Dutch listed real estate companies like Corio N.V., NSI N.V. Unibail-Rodamco S.E., VastNed Retail N.V. and Wereldhave N.V. Their characteristics are that: (i) they are listed on a stock exchange; (ii) they are not open-ended; (iii) they implement a corporate strategy and not a defined investment policy; (iv) there is active involvement in day to day management; (v) they have various stakeholders such as shareholders, tenants and employees; not solely or primarily investors. Dutch REITs often claim that the AIFMD is not applicable to them. Although there is no statutory exemption from the AIFMD for these entities, and nor has the Dutch regulator stated that they are exempt, none of these Dutch REITs have applied for authorization under the AIFMD.
Valuation	How have the valuation rules and standards been implemented in respect of alternative real estate funds?	The valuation of assets of real estate AIFs may be performed by an AIFM or by an external valuer. The Authority for Financial Markets (AFM) will provide supervision, probably in cooperation with the Dutch Central Bank (DNB). The AIFMD provides that AIFMs must establish appropriate and consistent procedures for the proper and independent valuation of the assets of real estate funds. AIFMs must ensure that the rules applicable to the valuation of assets and the calculation of the NAV per unit or share in a real estate fund are followed. Both the assets and the NAV must be valued at least once a year. Unit holders must be kept informed. If an external valuer performs the valuation, an AIFM must demonstrate that the external valuer holds professional registration, is competent, and that the appointment complies with the requirements of the AIFMD. The valuer must be independent of the fund, the relevant AIFM, or any other persons with close links to the fund. This duty may not be delegated to a third party. A depositary cannot be appointed as an external valuer, unless the functions are separated. An AIFM may also perform the valuation itself, although in that case the valuation task must be functionally independent from portfolio management and the remuneration policy (and the relevant managers of the AIF should consider conservative valuation policies). Conflicts of interest and undue influence affecting the employees must be prevented. Any potential liability in connection with an improper valuation in respect of a real estate AIF and the unit holders in the real estate fund will lie with the AIFM. This applies even where an external valuer has been appointed though the an external valuer may be liable for all losses suffered by the AIFM where there has been a breach of duty or negligence. This liability cannot be excluded by contract.
Remuneration	Is promote/carried interest typically or specifically picked up in the variable part or is it treated otherwise?	Dutch law does not provide for a specific rule which classifies carried interest as variable remuneration. However, a draft bill regarding remuneration which has yet to be implemented, provides definitions of "fixed remuneration" and "variable remuneration" as follows: *Fixed remuneration* is: the share of the total remuneration which consists of unconditional financial or non-financial benefits as specified in the remuneration policy of the undertaking or in agreements as to the undertaking's purpose. *Variable remuneration* is: the share of the total remuneration which is not fixed remuneration. Importantly, the Bill provides detailed rules on the remuneration of all employees (ie, not only identified staff).
Depositary	Has your country implemented the option to permit non-banking institutions to perform the depositary functions in respect of real asset AIFs?	Yes. In addition to the list of entities entitled to function as depositaries under article 21(3) of the AIFMD, article 21(3)(c) of the AIFMD entitles the member states to appoint non-prudentially supervised entities as possible depositaries for assets other than financial instruments. This exception is of particular importance for real estate AIFs. The Dutch legislation repeats the requirements provided for in article 21(3)(c) of the AIFMD. In the Netherlands certain trust service providers advertise their services as depositaries for real estate AIFs. These market participants are well placed to fulfil the role of depositary under the directive, as in many cases they already manage the legal entity in the AIF structure which safeguards the legal titles of real estate assets. Several of these trust entities were appointed as depositaries in AIFMD permits which have recently been granted by the AFM.
Marketing	Did your country uphold its private placement regime in respect of EU AIFs managed by sub-threshold EU AIFMs and non-EU AIFMs; as well as non-EU AIFs?	The *de minimis* regime provided for in article 3(2) of the AIFMD is only available to AIFMs whose home state jurisdiction is the Netherlands.

See page 28 of this issue for details of the obligation on depositaries to verify assets, and page 30 for a more detailed discussion of Dutch REITs and the AIFMD.

NORWAY

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GENERAL TOPIC	QUESTIONS	
Scope	Has the AIFMD been implemented in your country? If so, when?	The AIFMD was incorporated into Norwegian legislation by the Alternative Investment Fund Act of 20 June 2014 (AIF Act) and regulations of 26 June 2014 (AIF Regulation). From that date a six-month transition period commenced during which all market participants had to assess whether or not they fall within the scope of the AIFMD. As of 1 January 2015 all parties which are governed by the AIFMD must comply with the new regime. According to the Norwegian Financial Supervisory Authority (FSA), the following ESMA guidelines apply: • guidelines on key concepts of the AIFMD • guidelines on sound remuneration policies under the AIFMD • guidelines on reporting obligations under articles 3(3)(d) and 24(1), (2) and (4) of the AIFMD
	Is there a distinction between or carve-out from the AIFMD for REITs, real estate investment funds (REIFs), real estate holding companies or similar structures in your country?	The terms REITs and REIFs are not commonly used in Norway. There is no statutory exemption from AIF Act for real estate companies or funds, nor has the Norwegian regulator expressly stated that they are exempt. It is up to each real estate company or fund to assess whether it is governed by the AIMFD. Usually a listed real estate company has a general commercial purpose and implements a corporate strategy rather than a defined investment policy. For these companies management is actively involved in the day-to-day management through actively operated property portfolios, acquiring real estate, improving and developing property projects and managing tenancy relationships and various stakeholders that may be involved, and as such, they do fall within the scope of the AIF regime. However, each undertaking does have to be assessed on an individual basis. Going forward, it seems likely that the Norwegian regulator will look to the EU and ESMA for further guidance.
Valuation	How have the valuation rules and standards been implemented in respect of alternative real estate funds?	The AIF Act provides that AIFMs must establish appropriate and consistent procedures for the proper and independent valuation of the assets of real estate funds. They must ensure that the valuation of assets and the calculation of the NAV be performed regularly and at least once a year. This valuation may be performed by an AIFM or by an external valuer. Detailed requirements with respect to the valuation are provided by the AIF Regulation. The AIFM must inform the holders of units of the valuation. Additional rules were introduced regarding the liability of AIFMs in connection with the correct valuation of assets. The manager is required to inform the Norwegian FSA about any outsourcing of the valuation function.
Remuneration	Is promote/carried interest typically or specifically picked up in the variable part or is it treated otherwise?	Taking "carried interest" to mean variable remuneration, we note that the definition of "carried interest" as set out in article 4(1)(d) of the AIFMD has been incorporated in the Norwegian AIF Act.
Depositary	Has your country implemented the option to permit non-banking institutions to perform the depositary functions in respect of real asset AIFs?	Yes. The depositary function may be performed by the list of entities set out in article 21(3) of the AIFMD as implemented by section 5-1 of the AIF Act. The Norwegian FSA may also approve non-prudentially supervised entities as possible depositaries for assets other than financial instruments where the terms set out in the AIF Regulation are met. The Norwegian FSA is currently considering applications from undertakings to be approved according to this rule.
Marketing	Did your country uphold its private placement regime in respect of EU AIFs managed by sub-threshold EU AIFMs and non-EU AIFMs; as well as non-EU AIFs?	Yes, the private placement regime applicable to managers whose home state jurisdiction is Norway and the same thresholds as set out in the article 3(2) of the AIFMD have been incorporated. However, a sub-threshold AIFM requires a permit to market its AIFs (other than national funds) to non-professional investors.

See page 31 of this issue for more details on Norway's approach to implementing the AIFMD.

POLAND

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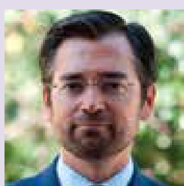
GENERAL TOPIC	QUESTIONS	
Scope	Has the AIFMD been implemented in your country? If so, when?	The AIFMD has not yet been incorporated into the Polish legal system. As the implementation deadline expired in June 2013, the European Commission called on Poland on 26 November 2014 to introduce new regulations and to present a report to the EC within two months of that request. On 14 January 2015 the draft Act was presented. It is structured as amendment to the Polish Act on investment funds dated 27 May 2004 and its goal is to implement AIFMD, directive 2014/91/UE, directive 2013/14/EU, and directive 2009/65/WE. The Polish regulator stated on 21 August 2013 that it is not possible to apply the terms of the AIFMD to any entities created and operating in Poland until the AIFMD has been fully implemented. However, since the relevant provisions of the AIFMD are directly applicable, Poland must ensure that any EU legal person (which, according to its domestic financial supervision authority, qualifies as an AIFM) is able to offer its units or shares to professional Polish investors. The date of final implementation of Polish legislation remains unknown and difficult to predict.
	Is there a distinction between or carve-out from the AIFMD for REITs, real estate investment funds (REIFs), real estate holding companies or similar structures in your country?	REITs and REIFs are not regulated as separate legal structures/entities under Polish law. However, the Polish market allows for close-ended investment funds which invest in real estate. The business activity of these entities must comply with the statutory regime, eg, they may not invest more than 25% of their assets in a single real estate project. It appears that the new Act will include managers of these funds within its scope.
Valuation	How have the valuation rules and standards been implemented in respect of alternative real estate funds?	The draft rules on asset valuation correspond directly with those given in the AIFMD. In general, an AIFM is entitled to perform the valuation itself, if it ensures that the procedures followed are independent from portfolio management activities. It is also open to the AIFM to appoint an external valuer. This valuer cannot be the same entity which examines AIFM's/AIF's financial statements or which is its depository, unless: • The valuation activities are functionally separate from the other delegated duties; and • Any potential conflicts of interest are mitigated. The valuer must be notified to the Polish FSA who may require the AIFM to change its valuer, if it is of the opinion that the valuer is not providing valid and objective valuation services. The draft rules go on to provide that valuation should be conducted by at least three persons who are qualified real estate valuation experts.
Remuneration	Is promote/carried interest typically or specifically picked up in the variable part or is it treated otherwise?	In Polish law there is no legal definition of "carried interest". The term may refer generally to the parts of remuneration which are variable and dependent on financial results. According to the Polish legislators charged with implementing the AIFMD, AIFMs will have to set out their remuneration policies for individuals who can substantially affect the risk management profile of the AIF (namely, board members). The remuneration policy should be appropriate to the structure of the particular AIF and its manager, and flexible. Forthcoming regulations are expected to detail requirements for the AIF's policy on risk management.
Depositary	Has your country implemented the option to permit non-banking institutions to perform the depositary functions in respect of real asset AIFs?	Yes. Polish regulation will allow AIFMs to conclude depository agreements with: (i) domestic banks, (ii) Polish branches of credit institutions, and (iii) the Polish National Depository for Securities (in Polish: *Krajowy Depozyt Papierów Wartościowych*). In addition, the manager of a (real estate) close-ended investment fund may also appoint as its depository a brokerage firm with a registered capital at least of EUR 730,000. The firm must be authorized to perform investment services and various other activities relating to financial instruments.
Marketing	Did your country uphold its private placement regime in respect of EU AIFs managed by sub-threshold EU AIFMs and non-EU AIFMs; as well as non-EU AIFs?	The draft regulations implementing the AIFMD state that the *de minimis* regime provided for in the AIFMD is to be applied only to AIFMs whose registered office is in Poland.

SPAIN

CONTACTS



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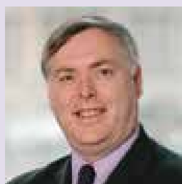
GENERAL TOPIC	QUESTIONS	
Scope	Has the AIFMD been implemented in your country? If so, when?	Prior to the implementation of the AIFMD, all open-ended funds and managers were regulated under Act 35/2003, of 4 November, on Collective Investment Schemes (CISA), while only some close-ended funds and managers fell under Act 25/2005. Although the AIFMD was incorporated into Spanish law by Act 22/2014 on 12 November 2014, on Private Equity Funds, Managers and other Closed-ended Collective Investment Schemes (PEA), the dual approach described above was retained: CISA, amended by PEA, still provides the regulatory framework for all open-ended funds and managers; and PEA covers all close-ended fund managers.
	Is there a distinction between or carve-out from the AIFMD for REITs, real estate investment funds (REIFs), real estate holding companies or similar structures in your country?	Yes. In 2009 a specific regulatory framework was enacted for listed real estate investment companies (SOCIMIs) through Act 11/2009. In addition to the special tax regime provided by the Act, it also provides for an express authorization which distinguished between SOCIMIs and real estate investment funds under CISA (ie, open-ended real estate collective investment schemes), indicating that SOCIMIs are a different type of investment vehicle. Consistent with this interpretation, PEA expressly excludes SOCIMIs from its scope.
Valuation	How have the valuation rules and standards been implemented in respect of alternative real estate funds?	*Open-ended AIFs:* CISA provides that the value of open-ended AIFs must be assessed at least once a year by a real estate valuation entity ("authorized RE valuer"), applying the valuation criteria set out under Order ECO/805/2003. *Close-ended AIFs:* In contrast to the specific regulatory approach taken to the valuation of real estate assets owned by open-ended funds, legislators have not included this specific reference in PEA; rather, they opted for mirroring the regime of section 19 of the AIFMD; ie, laying down general principles and objectives. The main principle under PEA in relation to asset valuation is to ensure that "appropriate and consistent procedures are established so that a proper and independent valuation of the assets of the AIF can be performed". In order to achieve this, PEA establishes that "the rules applicable to the valuation of assets and the calculation of the net asset value per unit or share of the AIF shall be those enclosed in the internal rules or by-laws [as the case may be] of the AIF, in accordance with the criteria set out by the CNMV". As with the regime governing open-ended funds under CISA, both the value of the assets and the NAV of the AIF must be calculated at least once a year. Due to their less liquid nature, valuation must also take place whenever there is an increase or a decrease of the capital of the AIF. PEA generally reflects the provisions of the AIFMD regarding the performance of valuation. Finally, it should be noted that any potential liability in connection with an improper valuation in respect of a real estate AIF and the unit holders in the real estate fund will lie with the AIFM.
Remuneration	Is promote/carried interest typically or specifically picked up in the variable part or is it treated otherwise?	In relation to the design and implementation of remuneration policies for AIFMs, both CISA and PEA set out a number of principles with which remuneration policies must comply. However, no specific rules on carried interest have been provided. It remains to be seen whether such rules will be provided in the future.
Depositary	Has your country implemented the option to permit non-banking institutions to perform the depositary functions in respect of real asset AIFs?	No, the legislative provision enabling such entities to perform such functions has not yet been implemented.
Marketing	Did your country uphold its private placement regime in respect of EU AIFs managed by sub-threshold EU AIFMs and non-EU AIFMs; as well as non-EU AIFs?	*Open-ended AIFs:* Since 2003, the marketing of units or shares in open-ended AIFs has been subject to the domestic prior authorization procedure set out in CISA. The amendments to CISA have only resulted in the granting of a free marketing regime for EU AIFs managed by EU AIFMs thus generally upholding the prior authorization-based procedure for the marketing in Spain of any other open-end AIFs. Furthermore, CISA provides that section 30bis of the Spanish Securities Market Act does not apply to the offering of shares or units of open-ended AIFs managed by AIFMs, thus preventing any private placement of any open-ended AIFs by AIFMs. *Close-ended AIFs:* Similarly, PEA sets out a marketing regime requiring all AIFMs managing close-ended AIFs seeking to market those AIFs in Spain—except for close-ended EU-AIFs managed by EU AIFMs—to obtain domestic prior authorization from the CNMV. Due to the priority of PEA over the Spanish Securities Market Act, it appears that the prior private placement regime available under the Spanish Securities Market Act is no longer available.

UK

CONTACTS



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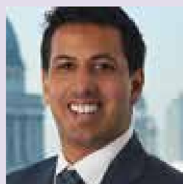

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GENERAL TOPIC	QUESTIONS	
Scope	Has the AIFMD been implemented in your country? If so, when?	The AIFMD was implemented in the UK by the Alternative Investment Fund Managers Regulations 2013 which entered into force on 22 July 2013. Amendments were also made to the FCA Handbook, the principal rulebook of the UK Financial Conduct Authority (FCA), and key pieces of existing financial services legislation including the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.
	Is there a distinction between or carve-out from the AIFMD for REITs, real estate investment funds (REIFs), real estate holding companies or similar structures in your country?	There is no specific carve-out from or distinction made in the AIFMD in the UK for REITs, REIFs or similar structures. The FCA has indicated in published guidance that a REIT is a concept used for tax purposes and that there is no presumption either way as to whether or not a REIT is captured by the AIFMD in the UK. Regard must be had to the operations, commercial purpose and circumstances of a REIT (or similar structure) to establish if it has a commercial or industrial purpose as a continuing company.
Valuation	How have the valuation rules and standards been implemented in respect of alternative real estate funds?	FUND 3.9 in the FCA Handbook implements the valuation requirements for AIFMs. There are no specific requirements for alternative real estate funds. The AIFM must ensure any valuation of the AIF's assets is performed impartially with all due skill, care and diligence. Procedures must also be put in place to allow for proper and independent valuation of the AIF's assets and for disclosure of a publication to investors of the NAV per unit or share of the AIF. The AIFM must ensure that the assets of any AIF it manages are valued at least once a year. In an open-ended AIF, valuations should be carried out at a frequency appropriate to the assets held by the AIF and the frequency of redemption of shares or units in the AIF. The AIFM may perform this function itself provided that the valuation function is independent from portfolio management and that the AIF's remuneration policy ensures conflicts of interests are mitigated and undue influence on employees prevented. The AIFM may appoint an external valuer. The external valuer must be independent of the AIF, the AIFM and any person with close links to the AIF or AIFMD. The AIFM must also be able to demonstrate that the external valuer holds professional registration, is competent, and that the appointment complies with the requirements of the AIFMD.
Remuneration	Is promote/carried interest typically or specifically picked up in the variable part or is it treated otherwise?	"Remuneration" for the purposes of the AIFMD has been interpreted widely in the UK to include any carried interest paid by an AIF. The remuneration rules from the AIFMD as implemented in the UK in the "AIFM Code" in the FCA Handbook need not be applied to all carried interest provided that the structure in question satisfies "objectives of alignment of interest with investors and avoids incentives for inappropriate risk taking". This guidance from the FCA will apply in addition to the similar but much narrower criteria published by ESMA in its guidance for disapplying the remuneration requirements.
Depositary	Has your country implemented the option to permit non-banking institutions to perform the depositary functions in respect of real asset AIFs?	Yes. An AIFM, for each UK AIF that it manages, must ensure the appointment of a depositary, that is a firm established in the UK and which is one of the following: • A credit institution, that is, a bank; or • An investment firm within the meaning of the Markets in Financial Instruments Directive with the necessary regulatory capital and permissions/authorizations to safeguard and administer assets; or • Certain other categories of institution subject to prudential regulation and ongoing supervision such as the trustee of a unit trust scheme or depositary of an investment company with variable capital.
Marketing	Did your country uphold its private placement regime in respect of EU AIFs managed by sub-threshold EU AIFMs and non-EU AIFMs; as well as non-EU AIFs?	The private placement regime in the UK was upheld following the implementation of the AIFMD. The UK implementation draws a distinction between "above threshold" or "full scope" AIFMs and "sub-threshold" or "small" AIFMs, being AIFMs with assets under management of less than EUR 500 million for unleveraged funds and EUR 100 million for leveraged funds. A small AIFM may market an EU AIF or non-EU AIF in the UK by notifying the FCA and submitting certain limited information to the FCA in respect of the AIF. A full scope non-EU AIFM, in order to market an EU AIF or non-EU AIF in the UK, must comply with the AIFMD's requirements in respect of providing an annual report to investors, disclosing certain information to investors before they invest and complying with the requirements of the AIFMD in respect of asset stripping and controlling interests of non-listed companies.

UNDERSTANDING FOUR KEY CHANGES TO THE HONG KONG REIT CODE

LUKE GANNON AND CHRISTOPHER KNIGHT, HONG KONG

Following completion of an industry consultation process which was held during the first quarter of 2014, the Hong Kong Securities and Futures Commission (the Commission) formally updated the Code on Real Estate Investment Trusts (REIT Code) in August 2014 to reflect the conclusions drawn from the consultation process. The Commission has now issued an updated set of "*frequently asked questions*" (FAQs) to the REIT Code, in order to provide further guidance on the Commission's interpretation of certain key sections.

The purpose of this article is to summarize the four main changes to the REIT Code arising from the consultation process, and to assess how these changes may impact both existing REIT managers and new applicants to the Hong Kong REIT market.

Background

The Commission's stated aim was to introduce greater flexibility to the existing REIT regulatory regime in Hong Kong. The consultation specifically addressed proposals to allow Hong Kong REITs to invest in: (i) properties under development (and to undertake property development activities); and (ii) financial instruments (including listed/ unlisted securities and domestic and overseas property investment funds).

This re-evaluation of the Hong Kong REIT Code can be seen as an effort to broaden the investment landscape available to a Hong Kong REIT, in order to bring the Hong Kong regulatory regime more in line with other established REIT regimes (in particular, that of Singapore), and to stimulate interest in the Hong Kong REIT market (to date there are only 11 authorized Hong Kong REITs).

Key changes

The main changes to the REIT Code are as follows:

1. *Relaxation of the requirement that a Hong Kong REIT may only invest in pre-existing income-generating real estate assets (Chapter 7.1)*

   A Hong Kong REIT may now

acquire uncompleted units in a building which is unoccupied and non-income producing, or in the course of substantial development, redevelopment or refurbishment (uncompleted units). This provides a REIT manager with greater flexibility to consider alternative investment opportunities as part of a REIT's general portfolio of investments. However, the Commission has sought to maintain a level of certainty and stability for Hong Kong REITs, by imposing a requirement that at least 75 per cent of the gross asset value of a REIT must at all times be invested in real estate generating recurrent rental income.

2. *Relaxation of prohibition on undertaking property development (Chapter 7.2)*
   A Hong Kong REIT may now engage in "property development and related activities", defined under the REIT Code as "the acquisition of uncompleted units in a building by the scheme and property developments (including both new development projects and the re-development of existing properties)" (property development). Property development is permitted as part of the investment strategy of a Hong Kong REIT, subject to the requirement that aggregate investments by that REIT in all property development costs together with the aggregate contract value of any uncompleted units, do not exceed 10 per cent of the gross asset value of the REIT. For this purpose, refurbishment, retrofitting and renovations are excluded from the definition of property development. Together with amendment (1) (above), this change is designed to encourage those REIT managers with an opportunistic investment approach.
3. *Relaxation of prohibition on investing in vacant land (Chapter 7.2)*
   A Hong Kong REIT may now invest in vacant land where the REIT manager is able to demonstrate that such an investment is an integral part of the property development activities of a REIT (see above) and within the REIT's investment objective. See FAQ 40 (below) for a description of investments that are considered to be an integral part of a REIT's property development activities.
4. *Permitting investment in property-related instruments*
   Chapter 7.2B of the REIT Code now provides that a Hong Kong REIT may invest in a restricted number of permitted property-related instruments (relevant investments), being: (i) domestic and international listed securities; (ii) unlisted debt securities; (iii) government and other public securities; and (iv) domestic or international property funds. This change radically broadens the investment landscape for REIT managers, who were previously restricted to investing only in physical real estate assets. The change also brings the Hong Kong regime in line with the Singapore regulatory regime, which already permits such investments. A Hong Kong REIT manager may now hold part of its investment portfolio in such relevant instruments, allowing for a more diverse asset pool.

   Investment in relevant instruments is subject to the following restrictions: (i) the value of a REIT's holding of relevant investments issued by any single group of companies may not exceed 5 per cent of the gross asset value of the REIT; (ii) a relevant investment should be sufficiently liquid, able to be readily acquired/disposed of under normal market conditions and in the absence of trading restrictions, and have transparent pricing; and (iii) at least 75 per cent of the gross asset value of the REIT must be invested in real estate that generates recurrent rental income at all times. Again, this can be seen as an effort to maintain a fundamental level of stability and certainty within Hong Kong REITs, by limiting exposure to large or illiquid positions, and ensuring that the pre-existing income-generating real estate assets remain as the core of a REIT's investment portfolio. Further, guidance on the REIT Code prohibits investment in high risk, speculative and/or complex financial instruments and products, and expressly prohibits securities lending, repurchase transactions and OTC transactions.

Existing and prospective REIT managers should be aware that all of the above relaxations to the existing regime are subject to a number of restrictions, primarily the percentage that such investments may constitute as part of the overall portfolio of assets held by a REIT. It is expected that the Commission will require a clear demonstration from REITs that these restrictions can be met and a REIT considering investing in relevant instruments, for example, should be able to explain to the Commission the nature of such investments, and the associated risks.

Updated REIT Code FAQS

The updated REIT Code FAQS issued in August 2014 amended the responses for FAQS 6, 11 and 19. In addition, new FAQS 39–50 were added, providing clarification on the changes to the REIT Code. The following clarifications are of particular note:

1. **FAQ40**—In determining whether an acquisition of vacant land is an integral part of a property development project, the Commission will generally consider factors such as: (i) whether the land can be readily used for the property development project to be undertaken; and (ii) whether additional approvals (zoning, planning, government lease conditions, etc.) have to be obtained from relevant authorities for commencing the property development project.
2. **FAQ45**—A REIT manager must ensure that all relevant investments acquired by a REIT are independently and fairly valued on a regular basis in accordance with the REIT's constitutive documents, and in consultation with the REIT's trustee. FAQ45 notes that the valuation of relevant investments should be made in accordance with requisite accounting standards as well as best industry standards and practice. Both REIT managers and REIT trustees will need to carefully consider the process by which such "new" assets are valued, both on an initial and on an ongoing basis.
3. **FAQ49**—Before an existing Hong Kong authorized REIT engages in "property development and related activities", a REIT manager should first amend the existing investment scope, as set out in the REIT's constitutive documents (that is, the trust deed). The Commission takes the view that engaging in such activity would amount to a change in the investment objective/policy of an existing REIT, and as such, the approval of unit holders by way of a special resolution under the REIT Code would be required.

Conclusion

The amendments to the REIT Code represent an exciting opportunity for the Hong Kong REIT market, both for existing REIT managers considering investment opportunities, and for new entrants evaluating different jurisdictions. It is hoped that the relaxation of the previous restrictions will ensure that Hong Kong is considered as an attractive domicile choice for futures REITs, in particular, in terms of an attractive exit option for regional private equity investments.

UNCERTAINTY IN BELGIUM'S PRE-MARKETING RULES UNDER THE AIFMD

KOEN VANDERHEYDEN, AXELLE VAN DEN BROECK AND MATTHIAS PURNAL, BRUSSELS

Before the incorporation of the Alternative Investment Fund Managers Directive (AIFMD) into Belgian law, the marketing of units in alternative investment funds (AIFs) in Belgium was not regulated, unless it was considered to be a public offer. The Belgian Law of 19 April 2014 relating to alternative undertakings for collective investment and their managers (AIFM Law) lays down more stringent rules on marketing. Now the Financial Services and Markets Authority (FSMA) regulates and supervises the marketing of AIF units in Belgium, even if that marketing is addressed exclusively to professional investors.

For the purposes of the directive, "marketing" means "a direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares of an AIF it manages to or with investors domiciled or with a registered office in the Union". Belgium retains this wording in its AIFM Law. Marketing is a key concept within the AIFMD's legal framework, as only "marketing" as defined in the directive is regulated. Operations that do not fall within that definition are not subject to the AIF regime.

The use of "a direct or indirect offering or placement" is one of the key elements to consider when assessing whether certain activities constitute marketing. However, as the placing on the market of AIFs is a complex process which takes some time, it is not straightforward to determine the exact point when pre-marketing activities become marketing activities which trigger the restrictions and requirements of the AIFM Law. It is essential that the AIF manager (AIFM), or the persons acting on that manager's behalf, are able to determine the exact moment when their market research and approach to potential investors qualify as an offering or placement subject to the rules on marketing in the AIFM Law.

Although some EU member states have taken a broader stance and go beyond the concept of marketing in the AIFMD by determining that "marketing" covers any form of advertising and sales promotion, the general approach taken by most EU countries is that pre-marketing activities do not trigger any AIFMD requirements.

In Belgium, the general view is that there can only be an offering or placement in the sense used by the AIFM Law from the moment that the AIFM, or persons acting on his behalf, contact potential investors and invite them to buy or subscribe for shares or units of the AIF on the basis of final and comprehensive documents.

Such an approach is consistent with other Belgian legislation (for example, provisions governing the prospectus and the Undertakings for Collective Investment in Transferable Securities (UCITS) legislation) and makes it possible for AIFMs, or persons acting on their behalf, to assess local investors' appetite prior to addressing all AIF concerns. Moreover, the FSMA is of the opinion that the prospective fund does not need to be notified under the AIFM Law as long as the fund has not yet been legally set up, provided all documents are clearly marked as draft and all communications are structured in such a manner to suggest that it is not a formal offer nor solicitation and provided that it is not yet possible for investors to subscribe. This means that pre-marketing communication drafted by the manager to gauge the interest of the market and potential investors without any completed documents, such as a draft private placement memorandum (PPM) or teaser documents, should not fall within the definition of marketing of AIFs.

Another approach is the "reverse solicitation". This is where the investor approaches the manager of the AIF on his own initiative meaning that there is no overt marketing approach from the AIFM. Based on the above definition of marketing in the AIFMD, reverse solicitation would not be captured by the marketing requirements of the directive. The difficulty resides in what constitutes reverse solicitation and the interpretation by each national regulator. Some industry stakeholders see reverse solicitation as something of a slippery slope, because of the difficulty in drawing the line between what is passive and what is active marketing.

Distinguishing between "pre-marketing" and "marketing" is not always simple and varies from one country to another.

> "The concept of pre-marketing remains a nebulous one."

Unlike some other countries in the EU, Belgium seems to have taken the approach that pre-marketing activities generally do not trigger AIFMD requirements. An important criterion to determine the point where pre-marketing crosses the line into the territory of regulated marketing is whether the potential investors are approached by an AIFM with final and complete offering documents and whether it is possible for such investors to subscribe for shares or units of the fund on the basis of those documents.

Nevertheless, the concept of pre-marketing remains a nebulous one especially since a lack of EU-wide guidance has resulted in different approaches being taken by different EU member states. This creates difficulties for AIFMs planning their distribution strategy, as the same activity could lead to different interpretations in the various EU member states. It is therefore recommended that legal advice be taken at a very early stage in the AIF launch process in all cases where marketing is intended.

FRENCH OPPCI VEHICLES : MORE FLEXIBLE AND STILL TAX EFFICIENT

JULIA GASPARD AND MYRIAM MEJDOUBI, PARIS

Directive 2011/61/EU on Alternative Investment Fund Managers (AIFMD) was incorporated into French law by Order 2013-676 published in the *Official Journal* on 27 July 2013. The directive simplified the legal framework for asset management and collective investments funds, while enhancing professional and other investor protection and it is having a significant impact on the alternative investment fund industry in Europe and beyond.

A number of competitiveness measures have been taken to make French collective investment products more attractive, particularly real estate collective investment schemes (OPCIs) of which, according to a study published by the Financial Markets Authority (AMF) on 9 January 2015, there were more than 184 (at the end of 2013) operating with gross assets under management of EUR30.6 billion. Most of those pursue an investment policy focused on a specific real estate asset category, mainly office premises (more than 50 per cent of real estate assets) or retail premises (more than 20 per cent of real estate assets).

OPCIs are collective investment bodies whose securities are not listed on the stock exchange and whose purpose is investment in real estate. The setting-up of an OPCI is subject to prior agreement from the AMF, the OPCI being represented by a French portfolio management company (*société de gestion*) also approved by the AMF.

Since the implementation of the AIFMD in France, OPCIs are divided into two main groups: those that are open to general public investors with no minimum subscription amount (known as "*Grand Public*") and OPCIs open to professional investors (known as "*Organisme Professionnel de Placement Immobilier*", or OPPCI) with a minimum subscription of EUR 100,000. These represent approximately 90 per cent of OPCIs.

The purpose of OPCIs is investment in real estate assets that they lease, or that they build for the purpose of leasing, and that they hold either directly or indirectly, including those that have yet to be completed, all operations required for their use or resale, the carrying out of all types of works to these real estate assets, and, secondarily, the management of financial instruments and deposits. The implementation of the AIFMD in France enables OPCIs to hold real estate rights directly through financial leases (known as "*credit–bail immobiliers*") which was previously only possible through a corporate intermediary.

The real estate assets of an OPCI (which must constitute at least 60 per cent of its overall assets) mainly consist of real estate assets built or acquired in order to be rented, finance lease rights over such properties, shares in certain non-listed real estate companies, shares in listed real estate companies and shares in French or foreign OPCIs.

The AMF issues an authorization to OPCIs and OPPCIs after checking the information supplied in the regulatory documents (undertaking rules or articles of association and/or prospectus, where applicable) and in advertising documents. The AMF also monitors these funds throughout their lifetime.

OPPCIs are required to hold:

- real estate assets, accounting for at least 60 per cent of their portfolio (with some differences in portfolio composition for SPPICAVs (open-end real estate investment companies, known as "*sociétés de placement à prépondérance immobilière à capital variable*") and FPIs (unincorporated real estate investment funds, known as "*fonds de placement immobilier*");

> These real estate investment schemes are hugely tax-efficient.

- a cash reserve, accounting for at least 5 per cent of their portfolio; and
- the rest of the portfolio, which should be made up of financial assets (for example, securities).

This structure has the inherent characteristics of collective investment schemes enabling investors to enjoy greater liquidity, since the minimum real estate investment ratio is much lower than for an SCPI (*société civile de placement immobilier*) and fosters more dynamic financial management of the portfolio.

OPPCIs which take the form of an open-end real estate investment company are the most commonly used and can be set up as a French *société anonyme* with at least seven shareholders or as a French *société par actions simplifiée* with at least one shareholder as long as the bylaws do not prohibit the plurality of shareholders. The possibility of using the form of a *société par actions simplifiée* makes the use of OPCIs more flexible as it makes it possible to have only one shareholder and to avoid the complex scheme used in the past with multiple shareholders.

Among the mandatory advisers, an independent real estate valuer must be appointed who will provide an annual valuation of the real estate assets owned by the OPPCI. Following the incorporation of the AIFMD, only one real estate valuer is mandatory for OPPCIs (instead of two previously). In addition, a custodian (*dépositaire*) must be appointed, either a credit institution or an investment firm, which will monitor the management of the OPPCI as well as keeping the securities of the financial assets. Finally, a statutory auditor must be appointed to certify the annual accounts of the SPPICAV and to attest to the accuracy of the information provided.

These real estate investment schemes are hugely tax-efficient since SPPICAVs are exempt from paying corporate tax provided that they meet certain requirements and particularly if they comply with distribution obligations. In order to qualify for the corporate tax exemption, the SPPICAV is required to distribute within five months following the end of a fiscal year, at least (i) 85 per cent of the profits of the previous year; (ii) 50 per cent of the capital gain made from the sale of real estate assets during the financial year or the previous financial year; and (iii) 100 per cent of the net income of the previous financial year derived from distributions from companies held by the SPPICAV which benefit from a corporate tax exemption on their real estate activity.

Shareholders are taxed on the distributions received from the SPPICAV or gains on their shares. The level of taxation liability varies, depending on whether the shareholder is an individual or a company and whether the shareholder is considered to be a French resident for tax purposes.

However, the tax efficiency of a French OPCI involving Luxembourg shareholders will be adversely affected by an amendment to the France–Luxembourg treaty adopted on 5 September 2014. As from the ratification of this amendment, capital gains made by a Luxembourg company on the sale of shares of a company or OPCI holding, directly or indirectly, mainly real estate in France, will no longer be liable to tax in Luxembourg (where they could, in certain circumstances, be completely exempt from tax), but will instead be liable to taxation in France. However, it should be noted that this amendment takes effect as from the calendar year following its ratification. This means that all transactions completed during 2015 will still benefit from the current tax savings on capital gains related to the France–Luxembourg treaty.

SICAFS INTRODUCED IN ITALY AS REGULATED INVESTMENT VEHICLES

AGOSTINO PAPA, ROME

Introduction

As part of the implementation of the Directive 2011/61/EU on alternative investment fund managers (AIFMD), a new regulated investment vehicle, called "*società di investimento a capitale fisso*", or SICAF, has been introduced in Italy.

Under the AIFMD and Legislative Decree 58/1998 (known as the Unified Financial Act, or UFA), a SICAF is a close-ended alternative investment fund, that is, it is a scheme established as joint stock company with fixed capital and a registered office in Italy, having as its sole commercial purpose the investment of assets obtained through the issue of shares (or other equity instruments), among a number of investors, managed as a whole in the interest of its investors and independently from them. It invests mainly in real estate on the basis of a pre-determined investment policy.

This article provides a brief outline of the key characteristics of the SICAF, with a focus on those that invest mainly in real estate, and their marketing procedures. It should be noted that the law in this area is currently in flux due to the ongoing implementation of the AIFMD, and new regulation is expected shortly. Thus, the following is an overview of the Italian laws and regulations that are expected to come into force in the next few months.

Key characteristics of Italian real estate SICAFs

The establishment of a SICAF must be authorized by the Bank of Italy.

A SICAF whose shares can only be offered to professional investors and qualified investors (including, among others, stockbrokers and foreign persons authorized under their home state regulations) is classed as "reserved", as opposed to the "retail" SICAF, whose shares can be offered to any investor and may also be listed on a regulated market.

The SICAF can manage its assets itself, or appoint an external manager. Other entities involved in a SICAF's operations include, among others, a custodian bank, which is required to hold cash and the financial assets of the SICAF, in order to safeguard the investors' rights and property, an auditor to certify its accounts and any independent experts who may be appointed to provide valuations of real estate.

SICAFs above and below threshold

SICAFs may be described as either above threshold or below threshold.

Under the UFA, SICAFs below threshold are those reserved SICAFs:

(i) whose assets under management do not exceed EUR 100 million; or

(ii) whose assets under management do not exceed EUR 500 million, provided they are unleveraged and that the investors' right of redemption may not be exercised for a period of at least five years from the date of initial investment.

Reserved SICAFs below threshold are subject to slightly less onerous regulatory requirements than those which apply to SICAFs above threshold.

The authorization procedure

SICAFs are authorized by the Bank of Italy, in consultation with Consob. The authorization procedure must generally be completed within 90 days, though the period may be suspended where additional documentation is requested. The following conditions for authorization must be met:

(i) the entity must be a joint stock company;

(ii) it must have a minimum initial share capital of at least EUR 1 million (EUR 500,000 for reserved SICAFs, and EUR 50,000 for SICAFs below threshold);

(iii) its registered office and the head office must be in Italy;

(iv) its sole commercial purpose must be the collective investment of assets obtained through the offering of its shares and other equity instruments;

(v) its founding shareholders and the management team must meet the

integrity requirements established by the Ministry of Finance, in consultation with the Bank of Italy and Consob.

The application for authorization must include details of the SICAF's proposed activities, its plans for development, its objectives and a report outlining its administrative structure.

Reserved SICAFs are subject to a less onerous evaluation procedure than that which applies to retail SICAFs. Once authorization is given, the SICAF must commence its activities within one year.

Investment activity

SICAFs must be managed in accordance with a predetermined investment policy and, when they invest mainly in real estate, must typically comply with the following investment limits:

(i) They must invest an amount equal at least to 2/3 of their total value (which may, in certain circumstances be reduced to 51%) in real estate, rights in rem on real estate assets, equity interests in real estate companies and other real estate AIFs (these are known as "qualifying assets").

(ii) They may invest the remaining 1/3 of their total value in assets other than qualifying assets (for example, listed or unlisted financial instruments, in compliance with the relevant general prohibitions and investment limits provided by law).

(iii) They can invest in receivables relating to their own assets, meaning that they can lend money to third parties.

(iv) They cannot carry out any direct building activity.

Risk concentration limits and leverage

Under the Bank of Italy's new draft Regulation on collective asset management, SICAFs must comply with certain risk concentration limits. Reserved SICAFs may derogate from these limits, but even in these cases, a *de facto* minimum level of diversification of risk (based on the characteristics of the portfolio assets) must be ensured.

In terms of leverage, the Regulation provides that retail SICAFs must limit leverage to a ratio between total indebtedness and NAV not exceeding two, while no specific limit to the use of leverage is provided for reserved SICAFs. However, if the reserved SICAF consistently uses leverage (that is, the ratio between total indebtedness and NAV is higher than three), the Bank of Italy will step in to evaluate the adequacy of the SICAF's internal structure and risk management, and the potential impact of leverage on its financial stability.

Shares in a SICAF

Share purchase in a SICAF is subject to oversight by the Bank of Italy. There must be a plurality of investors but, under the Regulation, this requirement is met even where only one unitholder exists, provided that its investment is in the interest of a plurality of investors (for example, in the case of a fund of funds), or that the marketing of the shares in the SICAF was directed to a potential plurality of investors.

Where a reserved SICAF wishes to market its shares, notification must be sent by the intermediary to Consob, including a covering letter, outlining the SICAF's activities; a copy of its by-laws; and other information, including a description of how the SICAF intends to avoid marketing its shares to retail investors. Marketing may only commence on receipt of Consob's approval (to be issued within 20 business days).

Similar restrictions apply to the marketing of a retail SICAF's shares. They must also notify Consob and provide information on their activities. Again, marketing may only commence on receipt of Consob's communication (to be issued within 10 business days—the shorter term reflects the less onerous authorization procedure).

Retail SICAFs wishing to trade their shares on a regulated market must issue a prospectus. This is also subject to Consob's approval. Admission to trading is subject to authorization by the Italian Stock Exchange (*Borsa Italiana*) and is regulated by the Exchange.

EXPLORING FOREIGN INDIRECT INVESTMENT IN DUBAI'S REAL ESTATE MARKET

HELEN HANGARI, GHASSAN SHUHAIBAR AND JAMES CARTER, DUBAI

Dubai is known internationally for its dynamic real estate market and has attracted vast numbers of direct investors since "freehold" ownership for non-nationals in designated areas was announced in 2002 and the supporting law was published in 2006.

Over the course of the last 18 months, there has been an increasing trend for large real estate companies in Dubai to seek a public listing in order to raise funds or realize value in a family owned business. Such public listing has tended to either be on the London Stock Exchange (LSE) or the Dubai Financial Market (DFM) and enables international investors to indirectly invest into some of the leading real estate classes in Dubai including residential schemes, leisure assets, hotels and malls.

Listing on the LSE

A high profile example of a Dubai real estate company raising money via the LSE is Damac Properties which began trading global depository receipts (GDR) on the LSE in December 2013. GDRs are a negotiable instrument issued by a depository bank that evidences ownership of shares in a foreign company. The trading of GDRs does not constitute a trading of the underlying shares which remain in the custody of the depository bank. In the case of Damac Properties, each GDR constitutes three ordinary shares in the company. GDRs are offered to institutional investors through a private offering and are subject to the trading and settlement procedures of the LSE.

One of the reasons that Dubai real estate companies may choose to trade GDRs is due to the land ownership rules in Dubai which restrict foreign ownership to certain "designated" areas. If a plot of land is not in a designated area, ownership is restricted to nationals of the Gulf Cooperation Council (GCC) or companies wholly owned by them. The GCC countries are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates (UAE). By trading in GDRs, the ownership of the shares can remain with a bank which satisfies the nationality requirements of land ownership in Dubai but the GDRs can still be traded by non-GCC nationals.

GDRs often appeal to companies in the Middle East and other emerging markets as they enable issuers to offer securities in a sophisticated and developed market, such as London, thereby allowing them access to a broad range of international investors that they would otherwise not be able to reach. A listing of GDRs on the LSE requires adherence to a lower standard of corporate governance and disclosure requirements than a premium listing of equity shares would. Another key advantage of listing GDRs on the LSE is that issuers do not need to have their equity securities listed (following the deletion of LR18.2.10R in 2011) thereby avoiding the risk, cost and lengthy time implications that are associated with a full blown equity/securities issuance process.

Companies in the UAE are attracted to a listing on the LSE (as against a listing on the DFM) for many reasons including the added prestige, access to a greater number of investors and the ability to benefit from being able to list a lower proportion of its shares than would be required under the DFM regulations. Listing on the LSE only requires 25 per cent of the shares to be held by the public and the Alternative Investment Market (or AIM, the junior exchange in London) does not impose any such minimum requirement. Conversely, for a listing on the DFM (for non-family business companies), the minimum required percentage of the issued shares to be held by the public is 55 per cent. Such a high proportion of shares being listed is unattractive to many successful local entrepreneurs/family businesses (or government owned companies) who wish to retain a majority shareholding of the company. As a result of this, the DFM regulations have been changed whereby the minimum requirement for shares to be held by the public for family businesses seeking to list on the DFM was reduced to 30 per cent, thereby allowing the families to retain up to 70 per cent of the shares in the company. It is thought that this change will encourage many family businesses to seek to raise funds via an initial public offering (IPO). The regulations governing the DFM also prevent the founder of a company from personally making a cash return from a listing for a minimum of two years, which may also make an overseas listing more appealing.

A listing on the LSE also means that investors are not investing in an "emerging market", as is the case with shares listed on the DFM, thereby avoiding any negative connotations and financial risk that is associated with investing in such a "secondary" market.

Listing on the DFM

Despite the appealing aspects of a listing on the LSE, the DFM is still an attractive option for local companies. In December 2014, Damac offered the holders of its GDRs the option to convert these GDRs into shares in a Damac company which listed on the DFM. The GDR holders were offered 23 shares for each GDR that they held. Approximately 97 per cent of the GDRs were converted into shares of the DFM Damac listed entity.

Another recent example of a high profile listing on the DFM is Meraas Holding's theme park division, Dubai Parks and Resorts. Dubai Parks and Resorts is responsible for developing three theme parks in Dubai, namely a Legoland, a Hollywood amusement resort and a Bollywood movie theme park. In order to raise financing for the development of these parks, the company listed on the DFM in December 2014, raising approximately US$680 million. The listing allows international investors to indirectly invest in the leisure, travel and tourism market in Dubai which is aiming to attract 20 million visitors a year by 2020 when the Emirate hosts the Expo.

In the case of Dubai Parks and Resorts,

> Emerging markets are an integral part of a global equity portfolio's allocation.

of the shares that were offered pursuant to the listing, 60 per cent were offered to institutional investors outside of the UAE, 25 per cent were offered to institutional investors and high net worth individuals within the UAE, 10 per cent for UAE retail investors and, as per the federal legal requirement (UAE Council of Minsters' Resolution No. 8 of 2006), 5 per cent was offered to the Emirates Investment Authority.

When considering a listing on the DFM, it is important to note the regulatory requirements with regards to the listing entity's share capital. These regulations state: (i) the paid up capital should not be less than 35 per cent of the shareholders' equity or not be less than AED 25 million (whichever is higher); (ii) the shareholders' equity for each category of shares that the company has issued should be equal; and (iii) the shareholders' equity may not be less than the paid up capital at the date of the application for listing. Also, the company applying for the listing should have been incorporated for a minimum of two years, with audited financial statements issued for each year. An additional benefit of listing on the DFM is that "public joint stock companies" in Dubai are permitted to own property throughout Dubai and not only in the areas designated for foreign ownership.

Another prominent listing which took place on the DFM in October 2014 was of Emaar Malls Group, which listed 70 per cent of its shares. This has allowed international investors to indirectly invest in the highly popular retail sector in Dubai. Emaar Malls Group PJSC owns four significant malls, 30 community shopping centres and other retail space in Dubai consisting of approximately 5.9 million square feet (as at 30 June 2013).

The DFM benefitted, in June 2013, from being awarded "emerging market" status by the Morgan Stanley Capital International (MSCI) annual market classification review. Emerging markets are an important and integral part of a global equity portfolio's allocation. The MSCI's emerging market index covers over 800 securities across 23 markets and represents approximately 11 per cent of world market cap. The addition of the DFM to the emerging market index increases the attractiveness of the DFM to foreign investors, which should encourage more companies from both the UAE and internationally to list their securities on it.

THE OBLIGATION OF DEPOSITARIES TO VERIFY OWNERSHIP UNDER THE AIFMD

RUTGER ORANJE AND PATRICK KEPPENNE, AMSTERDAM

Introduction

Since the global financial crisis in 2008, many institutions and persons active in the financial markets have been subject to an increasing number of regulations and directives, including, of course, the Alternative Investment Fund Managers Directive 2011/61/EU (AIFMD), imposing obligations, rules and procedures on not only alternative investments funds (AIFs) and managers acting on behalf of AIFs (AIFMs), but also on their depositaries. One of the obligations of a depositary is to verify the ownership of assets of the AIF or the AIFM and to maintain a record of those assets (asset verification). Apart from providing an obligation to keep up-to-date records (article 21(8)), the AIFMD does not stipulate many guidelines on how the obligation to carry out asset verification may be complied with in practice. In 2013, a Commission-delegated Regulation (EU) No. 231/2013 (the AIFMD Supplement), provided some additional guidelines on asset verification by depositaries. However, the question remains open as to whether the depositary needs to carry out an independent (own) asset verification (or can rely on documents provided by the AIFM instead), and if the former, how frequently such an independent asset verification should be carried out.

The absence of any concrete guidelines on asset verification presents depositaries with a dilemma. On the one hand a depositary must comply with its obligations under the AIFMD, but on the other hand it is aware that an independent asset verification, especially if it is to be undertaken frequently, is a time-consuming and expensive activity. This article reviews the relevant legislation and suggests how depositaries may comply with their obligations in this area. It should be noted that this view may not correspond with the view of the European Securities and Markets Authority (ESMA), who—to the best of the authors' knowledge— has not provided any guidelines on these matters.

Two-way street

The most important article on asset verification is article 90 of the AIFMD Supplement. From this article, it can be seen that the asset verification is a two-way street: both the AIFM and the depositary have responsibilities to ensure that the asset verification is performed correctly. Indeed, they are, to a certain extent, dependent on each other.

The AIFM must provide the depositary with relevant information on an ongoing basis. The frequency of "ongoing" is not defined in article 90, but it does state that the AIFM must ensure that third parties provide the depositary with certificates or other documentary evidence (i) every time there is a sale or acquisition of assets and (ii) *at least once a year.* Thus, at the very least, the AIFM must keep the depositary informed of the status of the AIF's assets at least once a year.

The depositary's obligations are specified in more detail, but entail (briefly) (i) an obligation to hold an up-to-date inventory of the AIF's assets at all times and (ii) an obligation to possess sufficient and reliable information to carry out an asset verification.

Correct procedures in place

Effectively, these two obligations imply that the depositary must at least have sufficient procedures are in place so that the AIF's assets cannot be assigned

or otherwise transferred without the depositary having been informed of that. As noted above, this is a two-way street, as the depositary will (partly) be dependent on the AIFM or a third party providing the information to him. This means that even though the depositary has an obligation to keep its inventory of the AIF's assets up to date, if the AIFM does not inform the depositary (intentionally or unintentionally) of any sale or acquisition, it may prove difficult to rule that the depositary has failed to keep an up-to-date inventory, provided the depositary has adequate procedures in place. However, the obligation of the AIFM to ensure that the depositary be informed at least once a year is clearly laid down in article 90, meaning the depositary is (or at least, should be) aware of this obligation and should make sure the AIFM complies. Therefore, if the inventory of the AIF's assets turns out to contain out-of-date and/or incorrect information while no verification has been carried out at least once in that particular year, the depositary could be held responsible for this out-of-date and/or incorrect information.

Independent asset verification

It is not clear whether the procedures outlined above include sufficient safeguards for a depositary to satisfy the requirements for an "up-to-date inventory" and "sufficient and reliable information", or whether an independent asset verification is required as well. Article 90 of the AIFMD Supplement clearly formulates the responsibility for the depositary as broadly as possible, so that this obligation *may* include an *independent* asset verification as well. However, if the depositary carries out this ownership verification itself and compares it to the information it has received from the AIFM (and checks for any discrepancies), it may be concluded that the depositary has fully complied with the obligations under article 90 of the AIFMD Supplement.

Recommendations

Based on the above, the depositary would be advised to carry out an independent asset verification in the following circumstances:

- If the AIFM provides the depositary with comprehensive and up-to-date information at least once a year, and the depositary has no (reasonable) doubt that the information provided by the AIFM is incorrect or incomplete, then it is considered that the depositary need not carry out an additional asset verification.
- If the AIFM provides the depositary with information, and the depositary has (reasonable) doubt that the information provided by the AIFM is incorrect and/or incomplete, the depositary should notify the AIFM of that immediately and ask for the additional information required to assuage that (reasonable) doubt. Should the depositary still not be satisfied with the information provided by the AIFM, then it is recommended that the depositary carry out an additional independent asset verification.
- Irrespective of the above, it is recommended that the AIFM carries out an independent (own) asset verification at least once every three years.

IS THE AIFMD APPLICABLE TO DUTCH REITS?

JULIET DE GRAAF AND HENDRIK BENNEBROEK GRAVENHORST, AMSTERDAM

Introduction

Since the first draft of the Alternative Investment Fund Managers Directive (AIFMD) there has been a lack of clarity about the regulatory status of Real Estate Investment Trusts (REITs). Discussions revolve around the question of whether or not the AIFMD applies to REITs.

As yet, no common position on a European level (for example, by the European Securities and Markets Authority (ESMA)) has been taken on this. Dutch legislation does not contain provisions which expressly include or exclude the applicability of AIFMD to REITs established in the Netherlands (Dutch REITs, or DREITs), and nor has the Dutch regulator published a view on the matter. Consequently, there is some uncertainty in the Netherlands with regard to the regulatory status of DREITs, and whether or not they fall within the scope of the AIFMD.

This article discusses the current regulatory status of DREITs under the AIFMD, as implemented in Dutch laws and regulations.

Dutch REITs and their regulatory status under the AIFMD

Historically the term DREIT referred to a property vehicle with a special "flow-through" tax status. Nowadays, the term is used to describe listed property companies more generally, including those that do not have a special tax status. DREITs are involved in a range of activities related to the construction, refurbishment, investment, operation and management of real estate.

Companies which (amongst others) are considered to be DREITs are Corio N.V., Eurocommercial Properties N.V., Wereldhave N.V., Unibail Rodamco, NSI N.V. and VastNed Retail N.V. These six companies are members of the Association for Dutch Stock Listed REITs (*Vereniging ter behartiging van de gezamenlijke belangen van beursgenoteerde fiscale vastgoedbeleggingsinstellingen*, which we will call "the Association").

Following input from the European Public Real Estate Association (EPRA) to ESMA's Consultation Paper, "Guidelines on Key Concepts of the AIFMD", the Association has published its view on the applicability of the AIFMD to DREITs.

First, the Association clarifies what it considers to be a DREIT. According to the Association, DREITs and similar property companies are no different from ordinary companies. The key characteristics of DREITs are:

1. they are listed on a stock exchange;
2. there is no obligation to buy back shares from shareholders (that is, they are not "open-end");
3. they implement a corporate strategy, not a defined investment policy;
4. they are actively involved in the day-to-day management of property, including construction, acquisition, refurbishment, operation and property management; and
5. they have various stakeholders, such as shareholders, tenants and employees and not only, or primarily, investors.

Taking the above characteristics of DREITs into account, the Association concludes:

> "The activities of DREITs, their active and day-to-day management of their assets/properties, their governance structure, the absence of a defined investment policy, and the fact that they do not only act in the interest of their shareholders but have to take into consideration also the interests of other stakeholders such as tenants and employees …, are well founded arguments that the AIFMD is not applicable to them."

Importantly, none of the six DREITs mentioned earlier have applied for authorization under the AIFMD, as implemented in the Netherlands.

Conclusion

The Association is of the view that there are well-founded arguments that DREITs, which exhibit certain characteristics, do not fall within the scope of the AIFMD. Notably, none of the DREITs which are members of the Association have applied for authorization under the Directive, and thus appear to consider that they are not alternative investment funds under the AIFMD. Rather, they seem to view themselves as "ordinary companies", that is, companies with a general commercial purpose within the meaning of ESMA's guidelines on key concepts of the AIFMD. Further, it appears that the Dutch regulator *implicitly* (ie it has not expressed a public view) agrees with them on this.

It is important to note that whether or not a company qualifies as a DREIT and thus whether or not it is not subject to the AIFMD must be carefully assessed on a case by case basis.

INTRODUCING FOREIGN REAL ESTATE AIFS IN NORWAY

CAMILLA WOLLAN, OSLO

Introduction

The Alternative Investment Fund Managers Directive (AIFMD) was implemented in Norwegian legislation by the Alternative Investment Fund Act of 20 June 2014 (AIF Act) and regulations of 26 June 2014 (AIF Regulation). As from 1 January 2015 all market participants governed by the AIF Act must now comply with the new regime.

The AIFMD regime will impact on the management, administration and marketing of alternative investment funds (AIFs). These are collective investment schemes not subject to the Undertakings for Collective Investment in Transferable Securities (UCITS) regime, typically hedge funds, private equity and real estate funds. Until now, these funds have been operating in a regulatory void outside the scope of European regulators, and the AIFMD is the first single market framework for this sector. The benefit of the AIFMD for market participants is the opportunity it gives them to passport their services throughout the EU, based on a single authorization. It also makes it easier for AIF managers (AIFMs) to market their funds to professional investors in line with the notification procedure (see below) across the EU/EEA.

Smaller AIFMs whose assets under management amount to less than EUR 500 million (for unleveraged funds with long lock-in periods) or EUR 100 million (for other types of AIFs) are subject to a regime tailored specifically to them. They are only required to register with the national regulator and to comply with limited reporting obligations. They will not, however, be entitled to passport their services or market their AIFs in other EU member states. This article considers only those AIFMs who are fully authorized under the AIFMD regime.

Real estate funds governed by the Norwegian AIF regime

The administration and ownership structure of Norwegian real estate companies and funds varies. The country has few listed real estate companies. The sector consists mainly of privately owned entities set up as private limited liability companies, limited partnerships or internal partnerships. The Norwegian state, insurance companies and pension funds are also large-scale direct owners of real estate. With respect to real estate funds there are approximately 25 to 30 fund providers in the Norwegian market, however, some of these are currently in the process of closing their real estate funds.

In terms of Norway's incorporation of the directive, there are no statutory exemptions for real estate companies and funds. It is up to each real estate company or fund to assess whether they fall within the scope of the AIF Act. This assessment should be based on the entity's structure, ownership, business purpose, governance structure and corporate documents; the type of undertaking is irrelevant.

Usually a real estate company has a general commercial purpose and strategy (that is, not a defined investment policy) and its management is involved in the day-to-day management through actively operated property portfolios, acquiring real estate, developing property projects and managing tenancy relationships, all of which factors tend to suggest that it is not an AIF.

According to the Norwegian Financial Supervisory Authority (FSA), the number of Norwegian applications for AIF status total about 35, 13 of which relate to securities asset management undertakings.

Marketing of real estate AIFs in Norway

With respect to the marketing of units (a direct and indirect offering or a placement) in AIFs (excluding national funds as defined in the AIF Act), different regulations apply depending on whether the marketing is to a professional investor (any client meeting two of three criteria: a total balance sheet of EUR 20 million; turnover of EUR 40 million; or own capital of EUR 2 million) or a non-professional investor (any investor not considered as a professional client, though they may apply to be treated as such). Each of these is considered in turn below.

The directive does not regulate the marketing of units in AIFs to non-professional investors. Each member state makes its own regulations in this area, and under Norwegian law, marketing of units in AIFs to non-professional investors is not permitted without FSA authorization. The regime applicable to marketing activities to professional clients is less stringent and is based on a notification procedure.

Marketing of real estate EU AIFs to professional investors in Norway

Marketing of units in real estate AIFs established within the EU to professional

investors in Norway must be notified in line with the article 32 of AIFMD and under the AIF Act, section 6-3.

The AIFM must submit a notification to the competent authority of its home state. The competent authority has 20 days after receipt of the notification to inform the FSA if the AIF is intended to be marketed in Norway. The AIFM is allowed to start marketing units in Norway as soon as it has received notification from the home state authority that the marketing notification has been filed.

The requirements for notification are set out in the regulations laid down by the home state. Where it is intended to market to investors in EU member states other than the home state of the AIF, the requirements for notification can be found in Annex IV to the AIFMD.

Marketing of real estate EU AIFs to non-professional investors in Norway

In Norway, an AIFM is allowed to market units of an EU AIF to non-professional investors subject to acquiring a marketing permit from the FSA.

The application for a permit to market an AIF to non-professional investors must include the key investor document and must describe the AIF's marketing plans, including measures taken to ensure that any marketing undertaken will comply with the applicable conduct of business rules, and include a statement that the AIF is permitted to be marketed to non-professional clients in their home state by the competent authority.

A key investor information document must be prepared for each AIF. The information is to be presented in a way that makes it easily understood, clear and not misleading, and capable of forming the basis of an informed investment decision. The document must be made available on the AIFM's homepage. Information for non-professional investors must be in Norwegian, unless the AIF Regulation provides an exemption from this, or a dispensation has been granted.

If the AIFM is required to publish a prospectus according to the Norwegian Securities Trading Act, chapter 7, only information not contained in the prospectus needs to be disclosed separately or given as additional information in the prospectus.

The AIFM must inform the FSA in advance of any material change to information provided in the marketing application. If the FSA believes that the change is not in line with the legislation, then it must inform the AIFM of that, and it also has the power to stop changes being made, or to take other measures to stop the marketing of the fund.

The FSA may also impose additional requirements on the AIFM when issuing the marketing permit if it considers that these are required to safeguard Norwegian investors.

Withdrawal of marketing permit

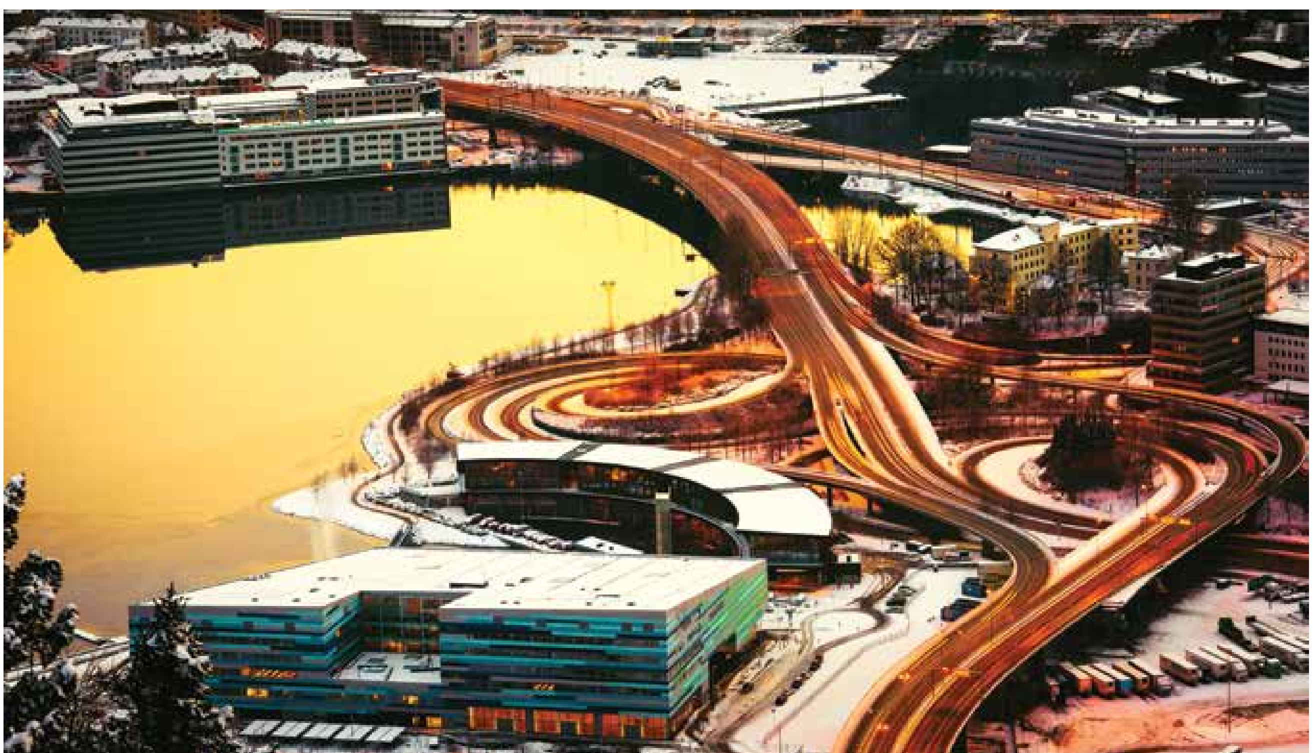
The FSA may revoke an authorization to market an AIF, if the requirements set out in the legislation are no longer being met, or where the conditions of the permit are breached. The FSA may, in exceptional cases, revoke a permit in order to protect non-professional investors.

Who may distribute units in an AIF?

The units of an AIF can be marketed by a manager with AIFM authorization, or an asset manager with authorization under the Norwegian Securities Fund Act, section 2-1. Other regulated entities may also be entitled to market units in an AIF, in cooperation with the manager. The AIF Act does not expressly make any provision as to who can distribute units in an AIF, other than the AIFM and asset manager, and this must be considered individually in each case.

Marketing of real estate non-EU AIFs established outside EU/EEA

It is permissible under Norwegian law for managers of non-EU AIFs to market AIFs to Norwegian professional investors. However, this is conditional on a marketing permit being issued by the FSA. The FSA has entered into Memoranda of Understanding with other foreign supervisory authorities to facilitate the marketing of non-EU AIFs in Norway.



SPANISH REITS TAKE OFF

MARÍA ALONSO, MADRID

After a wait of many years, the Spanish REIT regime (known as "*Sociedad Anónima Cotizada de Inversión en el Mercado Inmobiliario*", or SOCIMI) was introduced in October 2009. However, the crisis-stricken Spanish real estate market in 2009 onwards, added to the overly restrictive regulation and unattractive tax regime of SOCIMIs (which were subject to a corporate tax rate of 19 per cent) led to the failure of the regime, reflected in the fact that by 2012 not a single SOCIMI had been incorporated.

In December 2012, the Spanish government—aware that the initial regime did not meet real estate investors' expectations—introduced reforms in order to make SOCIMIs more attractive. The main feature of the new regime is that SOCIMIs now qualify for 0 per cent taxation, placing them on a par with the REITs of neighbouring countries in terms of tax liability. The reforms appear to have hit the right note, because under the new regime, a number of SOCIMIs have been incorporated. Moreover, the SOCIMI structure has become the preferred arrangement for large international investors to invest in Spain in those cases when divestment is planned only in the medium term.

Key features of SOCIMIs

SOCIMIs' activity

The purpose of SOCIMIs is restricted to the ownership of: (i) urban real estate acquired for leasing purposes, (ii) plots of land acquired for the development of urban real estate to be leased after development is complete and (iii) shares in other listed SOCIMIs or foreign REITs or non-listed Spanish or foreign companies that could be deemed to be assimilated to SOCIMIs or Spanish regulated real estate collective investment institutions.

Investment requirements: the 80–80 rule

At least 80 per cent of the value of the SOCIMI's assets must be invested in qualifying assets or shares and at least 80 per cent of its income (exclusive of capital gains) must arise from rental income and from dividends of qualifying shares.

There is no requirement regarding a minimum number of assets to be held by a SOCIMI, meaning that a SOCIMI can be incorporated with only one asset. A SOCIMI is therefore a viable option to structure major real estate projects having one company and one asset/set of assets per project (for example, shopping malls or hotels) with the objective of better managing risks and liabilities.

There is, however, a minimum holding period required: SOCIMIs' assets must be held for a minimum period of three years. Non-productive assets must be put up for lease but, if a tenant can be found within one year, that year will count towards the minimum holding period.

Mandatory distribution of dividends

The SOCIMI is required to distribute 80 per cent of profits arising from rental income and ancillary activities, 50 per cent of profits from the disposal of qualifying assets or shares and 100 per cent of profits arising from qualifying shares.

Listing requirements

SOCIMIs must be listed on a regulated stock exchange or multilateral trading facility in Spain, the European Union or the European Economic Area (for example, Spain, UK, Ireland, etc.).

Notwithstanding the general rule, non-listed Spanish companies whose main purpose is the acquisition of urban real estate for leasing purposes, that are subject to a mandatory dividend distribution regime similar to the SOCIMI regime, which comply with the investment requirements referred to above, and that are fully owned by one or more SOCIMIs or qualifying foreign REITs, may also apply the SOCIMI regime.

Tax regime

SOCIMIs are taxed at 0 per cent provided the shareholders owning at least 5 per cent of the SOCIMI are taxed on the dividends received at a minimum nominal rate of 10 per cent. Where shareholders do not meet this requirement, SOCIMIs are taxed at a 19 per cent corporate tax rate on the dividends distributed to those shareholders (this 19 per cent is a tax to be paid by the SOCIMI and not a withholding tax on the dividends distributed).

EU Directives and tax treaties

SOCIMIs are eligible for the avoidance of double taxation under the EU Directives and tax treaties signed by Spain.

For more on the origins of SOCIMIs and the reasons for their reform, see Orson Alcocer, "SOCIMIs—At Last, REITs in Spain" *Real Estate Gazette* (Issue 15, 2014) page 38 (hard copy) or page 70 (soft copy).

IRS CLARIFIES REIT DEFINITION OF "REAL PROPERTY" IN PROPOSED REGULATIONS

JESSE CRIZ AND BENJAMIN KARR BRIGGS, CHICAGO AND ROBERT LEDUC, MINNEAPOLIS

Real estate investment trusts (REITs) are an integral part of the US commercial real estate market. Many REITs are publicly traded. In addition, private REITs are a commonly employed investment vehicle in the private real estate market, particularly when non-US investors or tax-exempt investors are involved.

All REITs, both public and private, are creatures of the Internal Revenue Code of 1986, as amended. As such, REITs are subject to an array of tax requirements that are generally beyond the scope of this article.

In order to qualify as a REIT and avoid federal (and often state) income taxation at the corporate level, a REIT must meet a number of technical tax requirements. In order to maintain a beneficial status, at the end of each quarter of the calendar year, at least 75 per cent of a REIT's assets must consist of "real estate assets," certain cash items, receivables, and federal government securities. Real estate assets include real property and mortgage loans. In addition, income earned by a REIT from leasing real property is generally qualifying gross income under the REIT income tests.

The US Internal Revenue Service (IRS) recently issued proposed regulations intended to clarify the definition of "real property." These regulations are expected to reduce the volume of private letter ruling requests on the topic of what constitutes real property for REIT purposes. Significantly, they do not purport to change or revoke any prior rulings in this area.

Real estate assets

A key issue for most companies seeking to obtain or maintain REIT status is whether most of their assets constitute real estate assets. Further, this question is likely to be the most critical inquiry a non-traditional real estate company will face in determining whether its assets will allow it to obtain REIT status. The Code defines real estate assets as interests in real property, interests in mortgages on real property, shares in other REITs, and certain other short-term investments in debt and equity.

The term "interests in real property" includes "fee ownership" (that is, outright ownership) of, co-ownership of, leasehold interests in, and options to acquire land or improvements on that land (including options to acquire a leasehold interest, but the term does not include mineral, oil, or gas royalty interests.

These key REIT definitions under the Code are further interpreted under the current Treasury regulations, which define the term "real property" as "land or improvements thereon, such as buildings or other inherently permanent structures thereon (including items which are structural components of such buildings or structures)".

The current regulations further provide that local law definitions are not controlling for the purposes of determining the meaning of real property as used for the REIT tests and lay down a list of examples of real property, including wiring in a building, plumbing systems, central heating or central air-conditioning machinery, pipes or ducts, elevators or escalators installed in a building, and other items that are structural components of a building or another permanent structure.

Finally, the current regulations clarify that assets "accessory to the operation of a business" (even though such items may be termed fixtures forming part of the real estate under local law) are not real property, for example, machinery, printing presses, transportation equipment that is not a structural component of a building, office equipment, refrigerators, individual air-conditioning units, grocery counters, furnishings of a motel, a hotel, or an office building, etc.

The drafters of the existing regulations could not have foreseen many of the structures and/or assets that are now commonplace. Structures such as wireless towers and wind turbines were not explicitly contemplated by the current regulatory framework. Prior IRS guidance interpreted the current regulations as indicating that "a structural component is not considered real property for this purpose unless the interest held therein is included with an interest held in the building or inherently permanent structure to which the structural component is functionally related".

This guidance however does not resolve whether an improvement on land that is not a building should be considered an "inherently permanent structure" and thus real property, or whether tangible property that is affixed to a building (or other real estate asset) should be considered "a structural component of such building or structure" and therefore be included with the larger building or structure as real property.

IRS rulings and the *Whiteco* factors

The IRS has issued many private rulings on the qualification of certain assets as real property. When providing rulings on this issue, the IRS has generally considered the asset under the "*Whiteco*" factors. *Whiteco* was a case that examined whether certain property was either an inherently permanent structure or a tangible personal property for purposes of the now-repealed investment tax credit rules.

Whiteco laid down six factors to consider in making this analysis:

- Is the property capable of being moved, and has it in fact been moved?
- Is the property designed or constructed to remain permanently in place?
- Are there circumstances that tend to show the expected or intended

length of affixation, that is, are there circumstances that show that the property may or will have to be moved?

- How substantial a job is removal of the property and how time-consuming is it? Is it readily "removable"?
- How much damage will the property sustain upon its removal?
- What is the manner of affixation of the property to the land?

The IRS, guided by the current regulations and the *Whiteco* factors, has ruled that data centers, sign superstructures, and rooftop sites for wireless towers are all real property.

The proposed regulations

The proposed regulations were published on 9 May 2014. They lay down specific types of real property: land and improvements to land that include inherently permanent structures and structural components. The regulations also classify certain assets that are per se land, inherently permanent structures, or structural components and, if an asset does not fall within the specified categories, a set of factors with which to consider the asset. Significantly, the proposed regulations indicate that the analysis as to whether an asset is real property applies to "distinct assets," so the first question is "What is a distinct asset?"

Distinct assets

In determining whether an asset is a distinct asset, the proposed regulations provide that the following factors be taken into account:

- Whether the item is customarily sold or acquired as a single unit rather than as a component part of a larger asset
- Whether the item can be separated from a larger asset and, if so, the cost of doing so
- Whether the item is commonly viewed as serving a useful function independent of a larger asset of which it is a part
- Whether separating the item from a larger asset of which it is a part impairs the functionality of the larger asset

Once a distinct asset has been identified, the question is whether it constitutes land or whether it falls under the "improvements to land" rubric, either as an inherently permanent structure or a structural component.

Land

Land includes water and air space immediately above and natural products and deposits that are unsevered from the land. Natural products and deposits, such as crops, water, ores and minerals, cease to be real property when they are severed, extracted, or removed from the land. The storage of severed or extracted natural products or deposits, in or upon real property does not cause the stored property to be redefined as real property.

Specifically, under the proposed regulations, boat slips and end ties at a marina should generally constitute "land" for REIT purposes.

Inherently permanent structures

Under the new regulations, "inherently permanent structure" means any permanently affixed building or other structure. Affixation may be to land or to another inherently permanent structure and may be by weight alone. If the affixation is reasonably expected to last indefinitely based on all the facts and circumstances, the affixation is considered permanent. An inherently permanent structure must serve a passive function; a distinct asset that serves an active function, such as an item of machinery or equipment, is not a building or another inherently permanent structure.

Buildings

The current regulations provide that a building encloses a space within its walls and is covered by a roof. The proposed regulations provide that the term "building" includes the following permanently affixed distinct assets: apartments, houses, hotels, factory and office buildings, warehouses, barns, enclosed garages, enclosed transportation stations and terminals, and stores.

Other inherently permanent structures

Other inherently permanent structures are those that would qualify as real estate assets serving a passive function, such as to contain, support, shelter, cover, or protect, and do not serve an active function, such as to manufacture, create, produce, convert, or transport.

Under the proposed regulations, other such structures include the following permanently affixed distinct assets: microwave transmission, mobile telephony, broadcast, and electrical transmission towers; telephone poles; parking facilities; bridges; tunnels; roadbeds; rail tracks; transmission lines; pipelines; fences; in-ground swimming pools; offshore drilling platforms; storage structures such as silos and oil and gas storage tanks; stationary wharves and docks; and outdoor advertising displays for which an election has been properly made under the relevant legislation.

Factors in determining whether a distinct asset is an inherently permanent structure

If a distinct asset does not serve an active function and does not fall within the specific categories set out above, under

the proposed regulations, whether any such structure is an inherently permanent structure is based on all the facts and circumstances, in particular taking the following factors into account:

- The manner in which the distinct asset is affixed to real property
- Whether the distinct asset is designed to be removed or to remain in place indefinitely
- The damage that removal of the distinct asset would cause to the item itself or to the real property to which it is affixed
- Any circumstances that suggest the expected period of affixation is not indefinite (for example, a lease that requires or permits removal of the distinct asset upon the expiration of the lease)
- The time and expense required to move the distinct asset

Note that this analysis largely mirrors the analysis applied under current law reliant on the *Whiteco* factors.

Structural components

A structural component is any distinct asset that is a constituent part of and is integrated into an inherently permanent structure, serves the inherently permanent structure in its passive function, and does not produce or contribute to the production of such income, even if capable of producing income other than consideration for the use or occupancy of space.

If interconnected assets work together to serve an inherently permanent structure with a utility-like function (for example, systems that provide a building with electricity, heat, or water), the assets are considered together as one distinct asset that may be a structural component.

Importantly, "structural components are real property only if the interest held therein is included with an equivalent interest held by the taxpayer in the inherently permanent structure to which the structural component is functionally related".

Specifically, the proposed regulations establish that the following distinct assets and systems are "structural components": wiring; plumbing systems; central heating and air-conditioning systems; elevators or escalators; walls; floors; ceilings; permanent coverings of walls, floors, and ceilings; windows; doors; insulation; chimneys; fire suppression systems, such as sprinkler systems and fire alarms; fire escapes; central refrigeration systems; integrated security systems; and humidity control systems.

If a distinct asset is not one of those listed above, the question as to whether it is a structural component is based on all the facts and circumstances, in particular taking the following factors into account:

- The manner, time, and expense of installing and removing the distinct asset
- Whether the distinct asset is designed to be moved
- The damage that removal of the distinct asset would cause to the item itself or to the inherently permanent structure to which it is affixed
- Whether the distinct asset serves a utility-like function with respect to the inherently permanent structure
- Whether the distinct asset serves the inherently permanent structure in its passive function
- Whether the distinct asset produces income from consideration for the use or occupancy of space in or upon the inherently permanent structure
- Whether the distinct asset is installed during construction of the inherently permanent structure
- Whether the distinct asset will remain if the tenant vacates the premises
- Whether the owner of the real property is also the legal owner of the distinct asset

Intangible assets

If an intangible asset, including an intangible asset established under Generally Accepted Accounting Principles as a result of an acquisition of real property or an interest in real property, derives its value from real property or an interest in real property, is inseparable from that real property or interest in real property, and does not produce or contribute to the production of income other than consideration for the use or occupancy of space, then the intangible asset is real property or an interest in real property.

The proposed regulations also clarify the status of licenses and permits—a license, a permit, or another similar right solely for the use, enjoyment, or occupation of land or an inherently permanent structure that is in the nature of a leasehold or an easement generally is an interest in real property. However, a license or permit to engage in or operate a business generally is not real property or an interest in real property because it produces or contributes to the production of income other than consideration for the use or occupancy of space.

Conclusion

The proposed regulations, if adopted, should be welcomed by both existing REITs and companies interested in electing REIT status as they (1) offer a clearer framework for determining whether an asset will be considered real property for the REIT requirements; (2) essentially formalize existing letter rulings and thinking regarding certain permanent structures, structural components, water and air rights, and intangibles; and (3) greatly aid in the classification of certain assets as real property, with a certainty not possible under the existing law.

A version of this article appeared in the Fall 2014 issue of the PREA Quarterly, *a publication by the Pension Real Estate Association.*

CHANGES TO FIRB APPROVAL OF FOREIGN INVESTMENT IN AUSTRALIAN REAL ESTATE

JANE XU, MELBOURNE

The Federal Treasurer, assisted by the Foreign Investment Review Board (FIRB), administers the Foreign Acquisitions and Takeovers Act 1975 (Cth), the legislation that regulates foreign investment in Australia. FIRB examines applications by foreign investors to ensure their proposed investments are in line with government policy. Different rules exist for differing forms of foreign investment. Irrespective of the value of the land or the nationality of the investor, investment in vacant non-residential land and most residential real estate must have the approval of FIRB, unless the property falls into an exempt category.

Following the very recent commencement of a number of Free Trade Agreements and Economic Partnership Agreements between Australia and other countries, there have been changes to FIRB's approval requirements, ultimately making Australian real estate more appealing to investors from our foreign trade partners.

Changes introduced by the Japan–Australia Economic Partnership Agreement

Commercial real estate

The Japan–Australia Economic Partnership Agreement ("Japanese Partnership Agreement") commenced on 15 January 2015. One of the benefits of the Japanese Partnership Agreement was that the monetary threshold at which FIRB approval is required for Japanese investment in commercial real estate in Australia was increased. Now, Japanese investors are given the status currently enjoyed by US and New Zealand investors in Australia and fall within the category of "prescribed foreign investors". As a prescribed foreign investor, any investment by a Japanese entity in developed commercial real estate valued below $1,094 million no longer requires FIRB approval. Previously the threshold was significantly lower and any Japanese investment in developed commercial real estate above $248 million required FIRB approval.

Agricultural land

Under the Japanese Partnership Agreement, Australia has reserved the right to apply a lower threshold to agricultural land, with any investment of over $15 million in agricultural land by Japanese investors requiring approval.

Residential real estate

All investment in residential real estate will still require FIRB approval (unless it is an investment in a new residential dwelling where the developer already

has approval). However, such approval is generally granted expediently and without any conditions.

Changes introduced by Australia–Korea Free Trade Agreement

On 12 December 2014 the Australia–Korea Free Trade Agreement ("Korean Free Trade Agreement") came into force. The Explanatory Memorandum to Australia's proposed ratification legislation for the Korean Free Trade Agreement states that raising the monetary threshold for Korean investors was aimed at "promoting an increase in the flow of Korean investment into Australia".

Commercial real estate

Pursuant to the Korean Free Trade Agreement, Korean investors will also be subject to the higher monetary thresholds for investments in Australian commercial real estate and will only require FIRB approval if they propose to purchase a developed commercial property for in excess of $1,094 million.

Agricultural land

As with the Japanese Partnership Agreement, under the Korean Free Trade Agreement Australia has reserved the right of FIRB to review a proposed investment in agricultural land worth $15 million or more.

Residential real estate

All investment in residential real estate will still require FIRB approval (unless it is an investment in a new residential dwelling where the developer already has approval). Again, this approval is generally granted without any issue and in a timely manner.

Summary of changes for Japanese and Korean investment in real estate in Australia

Allowing Japanese and Korean investors to enjoy more favourable treatment by reducing regulatory requirements increases Australia's total real estate offerings to potential foreign investors. Investors from these countries no longer have to obtain FIRB approval for purchases of:

- developed commercial real estate valued below $1,094 million;
- rural/agricultural land valued at less than $15 million; or
- new dwellings from a developer where the developer already has obtained FIRB approval for the development.

It is worth noting that the higher threshold exemptions specified above are subject to several limitations. The exemption from FIRB approval will not apply where the proposed investment is:

- by a foreign government or government related entity;
- in a sensitive sector (such as media and telecommunications); or
- made by a foreign enterprise of either of the above countries which does not satisfy the ownership requirements; or
- made by an entity which is not incorporated in one of the above noted countries.

The following investments into real estate by Japanese and Korean investors will still require approval (however such approval is usually quickly granted without the imposition of any conditions):

- new dwellings; and
- any vacant land for the purpose of constructing a new dwelling.

Proposed changes under the Australia–China Free Trade Agreement

The precise impact that the Australia–China Free Trade Agreement ("Chinese Free Trade Agreement") will have on the rules relating to Chinese investment in Australian real estate remains to be seen. Whilst Australia waits for the Chinese Free Trade Agreement to come into effect, the speculation regarding the benefits which Chinese investors will receive continues. Most commentators agree that investors from China will receive the same benefits as countries who have previously reached Free Trade Agreements with Australia and also be granted the higher monetary threshold exemption (as detailed above) before FIRB approval is necessary.

State-owned enterprises

The Australian government has disclosed that investments by state-owned enterprises will continue to require approval irrespective of the value, however it was agreed that this would be reviewed at the request of China in three years' time.

Agricultural land

Within the past few years there has been a growing demand in China for top quality Australian produce. This has resulted in more and more Chinese investors opting to purchase agricultural land in Australia. The latest Agricultural Land and Water Ownership Survey released by the Australian Bureau of Statistics in June 2014 reports that since the last survey, an additional 4.7 million hectares of Australian agricultural land had been purchased by entities with some level of foreign ownership. In December 2014 it was reported that 50 dairy farms across Western Victoria (with a total net worth of $400 million) were purchased by a syndicate that included a Chinese state-owned enterprise. It has been speculated that, as with the Free Trade Agreements reached with other countries, Australia will reserve the right to have FIRB assess any investment proposals by Chinese investors in agricultural land valued above $15 million.

Forecast for further growth in foreign investment in Australia in 2015

A recent report by the investor, Dexus Property Group highlights the increased interest in Australian property, with the proportion of foreign investment

in commercial property reaching a record high in 2014, comprising 32 per cent of all real estate transactions in Australia. The two largest acquisitions of commercial properties in the December quarter were by Chinese investors, who purchased office space in central Sydney for $390 million and $425 million (respectively). Foreign investors are attracted to Australia's relatively stable economy and the potential for high income returns on their investments. In residential real estate, figures released in late 2014 show that in the nine months to March 2014, the approval of proposed foreign investment was 44 per cent higher than the same period in the previous year. The relaxation of FIRB requirements for foreign investors entering into Free Trade Agreements with Australia is forecasted to contribute to the continuation of this trend.

Indexed Monetary Thresholds

The tables below serve as a useful summary of the most recently indexed monetary threshold exemptions for FIRB approval by foreign investors for 2015.

(a) All foreign investors (excluding Chilean, Japanese, Korean, New Zealand and US non-government investors)

All foreign investors (excluding Chilean, Japanese, Korean, New Zealand and US non-government investors) will not require FIRB approval if their investments fall within the monetary threshold limits imposed by the Australian government for that particular type of investment	
Type of investment	**Maximum value of investment before FIRB approval required**
Developed non-residential *commercial real estate* where the property is *heritage* listed	$5 million
Developed non-residential *commercial real estate* where the property is *not* heritage listed	$55 million
An investment in: • An interest in an Australia business; or • An interest in an offshore company that holds Australian assets or conducts a business in Australia	If the value of the business or its assets is above $252 million

(b) Chilean, Japanese, Korean, New Zealand and US non-government investors

Chilean, Japanese, Korean, New Zealand and US non-government investors will not require FIRB approval if their investments fall within the monetary threshold limits imposed by the Australian government for that particular type of investment	
Type of investment	**Maximum value of investment before FIRB approval required**
Developed non-residential *commercial real estate*	$1,094 million
Involving "prescribed sensitive sectors": • An interest in an Australia business; or • An interest in an offshore company that holds Australian assets or conducts a business in Australia	If the value of the business or its assets is above $252 million
Not involving "prescribed sensitive sectors": • An interest in an Australia business; or • An interest in an offshore company that holds Australian assets or conducts a businesses in Australia	If the value of the business or its assets is above $1,094 million

LENDING BY INSURERS: NEW ITALIAN LEGISLATION

DAVID MARINO, MILAN

On 24 June 2014, Decree 91/2014 (known as the Competitiveness Decree) was published in the *Official Gazette*. The Decree aims to foster the growth of Italian companies through, amongst other things, facilitating access to new sources of financing. The Decree could also have an impact on the real estate sector.

In particular, the Decree added the following provision to paragraph 2 of article 114 of Legislative Decree no. 385 of 1 September 1993 (the Consolidated Law on Banking or TUB):

"2-*bis*. Italian insurance companies and SACE [an international insurance group with its headquarters in Rome] shall not carry out any kind of financing activity with the public, other than the granting of guarantees and only to parties that are not physical persons or microenterprises, as defined in art. 2, paragraph 1 of the Annex to Recommendation 2003/361/EC of the European Commission of 6 May 2003, within the limits set by Legislative Decree no. 209 of 7 September 2005 as amended by this Law, and related implementation provisions issued by IVASS [the supervisory authority for Italian insurers]."

Therefore insurers may now grant loans to companies within the limits laid down by the Decree and in line with the regulations issued by IVASS.

On 21 October 2014 IVASS approved the amendments to Regulation no. 36/2011, dealing with investments to cover technical reserves, which provides that insurance companies may now provide loans to enterprises within certain limits.

First, the amount of each loan must not exceed, as regards the share provided by the insurance company:

- 20 per cent of the amount of net equity shown in the last financial statements of the borrowing company;
- 1 per cent of the technical reserves of the insurance company.

Second, four different types of loans are envisaged:

1. direct loans to borrowers selected by a bank or a financial intermediary where all the following conditions are met (admissible within the maximum limit of 5 per cent of technical reserves to be covered):
   (i) the bank withholds a percentage of at least 50% of the loan and is entitled to the same rights as those of the insurance company (as regards interest and repayment of the principal);
   (ii) the borrowers have a high degree of creditworthiness;
   (iii) the financial statements of the borrower are audited;
2. direct loans to borrowers selected by a bank or a financial intermediary but where the conditions
   (ii) and (iii) above are not met (admissible within the maximum limit of 2.5 per cent of technical reserves to be covered);
3. direct loans to borrowers selected by a bank or a financial intermediary where the conditions under (i), (ii) and (iii) are not met (allowed within the maximum limit of 1 per cent of technical reserves to be covered);
4. direct loans to borrowers not selected by a bank or a financial intermediary (allowed under a specific authorization by IVASS).

IVASS can, in fact, authorize the autonomous carrying out of the activity entailing the identification of potential borrowers of direct loans following the evaluation of the plan relating to the investment of technical reserves approved by the insurer, taking account (among other things) of:

- the existence of a solvency capital requirement in excess of the minimum capital requirement; and
- measurements of capital absorption for direct loans that are the subject of evaluation to be made with a view to the future supervisory regime defined by Directive 2009/138/EU (Solvency II).

TAX BENEFITS RESERVED TO BANKS NOW EXTENDED TO INSURANCE COMPANIES ACTING AS LENDERS

CARLOTTA BENIGNI, MILAN

On 24 June 2014, by means of Decree 91/2014 (the "Competitiveness Decree"), the Italian government introduced provisions aimed at offering incentives for foreign investment in Italy and increasing Italian businesses' access to credit. The amendments impact two of the main aspects of financing: indirect taxation and application of withholding tax on interest payments. (See further David Marino, Agostino Papa and Nicoletta Alfano, "Acts to Encourage Competition in the Provision of Finance" *Real Estate Gazette* (Issue 18, 2014) page 14 (hard copy) and page 22 (soft copy) for a general overview of the provisions aimed at opening up the Italian lending market.)

Medium- to long-term financing (that is, loans that mature after a period of more than 18 months), the related formalities, as well as the execution, modification and redemption of such loans, and any related guarantee or security, subrogation, replacement, postponement, splitting or cancellation, including the assignment of receivables related to such loans, may in certain cases be exempted from registration tax, stamp duty, mortgage and cadastral taxes and governmental tax.

Under Presidential Decree No. 601 of 29 September 1973, article 15 ff, it is possible to opt for the application of a substitute tax levied at the rate of 0.25 per cent of the principal amount of the loan. This is an umbrella tax that replaces the ordinary indirect taxation of security such as mortgages, pledges or assignment of receivables. Such taxation is ordinarily applied at a proportional rate (for example, 2 per cent in the case of mortgages, 0.5 per cent in the case of pledges or assignment of receivables), thus imposing a significant tax burden on the borrower. The substitute tax not only reduces the amount of taxation to be paid when financing is initially taken out, but it also covers any subsequent borrowing and also additional guarantees forming part of the security package.

The main conditions to be met in order to benefit from the application of the substitute tax are the following:

(a) the loan must be granted by an Italian bank (or by an entity carrying on bank activity pursuant to Italian law), by the Italian branch of a European bank, or by a European bank which does not have a branch in Italy;
(b) the original maturity date of the loan agreement must be later than 18 months after the signing date; and
(c) the relevant loan agreement must be signed in Italy or executed therein.

The Competitiveness Decree has extended the application of the substitute tax so that it also applies where loans for terms longer than 18 months and one day are advanced by, among others, European Union insurance companies set up and authorized under their national regulations.

On this basis, direct lending by investors can also benefit from the substitute tax, and thus avoid registration tax, and mortgage and cadastral taxes on the security package.

This extension, together with the exemption from Italian withholding tax on interest payments made by Italian borrowers to European banks and insurance companies, also provided by the Competitiveness Decree, should reduce the obstacles in the way of foreign investors financing Italian entities.

With particular reference to the real estate sector, where most investments are financed through mortgage loans, the reservation of the substitute tax benefit to banks had the effect of reducing access to credit. Since August 2014, when the Competitiveness Decree came into force, foreign investors financed by insurance companies have also benefitted from a substantial reduction of the tax burden in the case of financing with security packages.

PORTUGAL'S POSITION IN THE EUROPEAN INVESTMENT MARKET

LUÍS FILIPE CARVALHO AND MARIANA D'ALMEIDA RIBEIRO, ABBC LAW FIRM, LISBON

Why invest in Portugal?

Portugal is currently developing a very solid investment strategy by granting residency authorization visas (known as golden visas) with the aim of attracting foreign investment. (For details of the golden visa regime, see Luís Filipe Carvalho and Maria Barão Assis, "Obtaining a 'Golden Visa' through Real Estate Acquisition" *Real Estate Gazette* (Issue 12, 2013) page 28; for more on real estate investment trends in Portugal generally, see Luís Filipe Carvalho and Maria Barão Assis, "Real Estate Investment Trends in Portugal" *Real Estate Gazette* (Issue 16, 2014) page 32 (hard copy) and page 56 (soft copy).)

The latest statistical data published by the Portuguese government reveals that a total of 1,936 golden visas were granted over a period of two years, with over EUR 1 billion being invested by foreign investors holding a golden visa.

It is important to note that 91 per cent of the total foreign investment referred to above has been in the real estate sector, and represents over EUR 60 million in taxes and EUR 20 million from the issue of visas. In just one month (November 2014), 132 new investors were registered and EUR 90 million poured into the real estate sector.

Portugal benefits from an attractive environment, a pleasant climate and a transparent tax regime, particularly advantageous to those wishing to retire to the country. All these factors tend to suggest that Portugal offers highly attractive investment opportunities. Notwithstanding the economic crisis that continues to blight much of Europe, investor confidence remains high and it may be justifiably asserted that no other investment strategy has achieved the positive results seen in Portugal's real estate sector. Further, success breeds success and Portugal's past performance in this sector means that investors are now highly confident that Portugal's real estate market can offer solid returns.

From a domestic perspective, this sector has assumed an important role in reaffirming Portugal's position as an attractive market in which to invest, compared to its European neighbours. It is also worth noting that, given the cyclical nature of investment, Portugal's eventual success in its current fight against unemployment should, in the long run, stimulate increased demand in real estate.

Commercial real estate

Commercial real estate has also been performing well, registering growth of 130 per cent in comparison to 2013. Investment in this area has doubled, and this is due in part to an increase in foreign investment greater than that registered in previous years.

Market commentators are forecasting that investment in commercial real estate in 2015 will continue to grow, possibly at a record rate, partly due to sales at levels not seen in 2014, such as the sale and purchase of real estate valued at over EUR 200 million.

In addition to these high value transactions, other commercial transactions for capital assets that have been in the offing for the past few years look set to be completed in 2015, boosting profits in this sector even further.

In the commercial rental market, as a general rule, rents have remained stable and vacancy rates have decreased substantially.

Portugal *versus* Europe

There are various factors that make Portugal attractive to foreign investors.

A country's cost of living, its climate, the quality of its health care and the strength of its hospitality industry are key factors when it comes to investment, and in all these areas, Portugal has much to offer. The country has been named as one of the ten best countries in the world in which to spend your retirement. In addition, real estate in Portugal is generally of high quality and offers investors good value for money.

For all these reasons, it would be fair to say that Portugal holds an exceptional position in the European real estate investment market.

RUSSIA CONTINUES TO LEGISLATE FOR THE ALLOCATION OF STATE-OWNED LAND FOR CONSTRUCTION

DIANA PRONYUSHKINA, MOSCOW

To date, a large proportion of land in Russia owned by the state (that is, public land) remains undeveloped and the state authorities are interested in bringing in private investors to develop it. To this end, a real effort is being made to improve land and town planning legislation to make the construction process easier for private developers.

Important recent amendments to the law in this area have been made with the aim, among other things, of simplifying the public land allocation procedure for commercial construction purposes. These changes take effect from 1 March 2015, and this article examines the amendments and their impact.

New public land allocation procedure

Current land legislation provides for two different procedures for allocating public land to interested parties depending on the purposes of the land use: (i) for construction; or (ii) for purposes which are not connected with construction. Public land may be allocated for construction purposes through: (i) a tender; or (ii) "the prior approval of the property location" procedure.

The current regulation of the public land allocation procedure for construction purposes is rather ambiguous and may be interpreted in different ways. In addition, it is not entirely clear when a tender is required and when the prior approval of the property location procedure may be applied.

Such uncertainty may lead to the disastrous situation of immovable property, which has been constructed in compliance with established requirements on a plot of public land allocated in accordance with the prior approval of the property location procedure, being deemed to be illegal and subject to a demolition order.

Under the new regulations, public land should be allocated through a tender in the form of a public auction regardless of its intended use (for construction or other purposes). In addition, public land designated for commercial construction may be allocated to interested parties

> The amendments should make the public land allocation procedure simpler, more efficient and clearer.

on a lease basis only and it cannot be privatized until after construction is completed.

There are some exceptional cases, strictly limited by law, when public land may be allocated for a construction lease without a tender. Such exceptions, among other things, include the following cases when rights to plots of public land are granted:

- on the basis of a decree of the Russian president;
- on the basis of a decree of the Russian Government regarding the placement of property for social or cultural needs, or regarding the implementation of major investment projects which meet criteria established by the Russian Government in a separate Act (to date, no Act has yet been adopted);
- in order to fulfil the international obligations of the Russian Federation, etc.

The law does not stipulate a specific term for lease agreements affecting public land. Under the new amendments, different terms may apply, depending on the type of property to be constructed. For example, in the case of the development of buildings or facilities, the lease term may vary from three to ten years, while leases on land where infrastructure is being constructed may last for a term of up to 49 years.

In addition, if the construction process is not completed within the term of the lease agreement, the courts may order the unfinished construction project to cease and that the land be sold by public tender.

Another important change is that every interested party is entitled to initiate an auction in relation to the specific plot of land. This is a step towards establishing the developers' right to choose plots of land for construction on an independent basis without relying on the local authorities' discretion.

An additional advantage claimed for the new procedure is the reduction of allocation terms to between two and three months in comparison to the three-year term employed under the current procedure.

Use of public land without a lease

Another important amendment is that, from 1 March 2015, public land may be used for certain purposes without the need to obtain a lease or easement right. This use will be allowed subject to a permit from the competent state/municipal authority and only if the intended use of the plot of land is one of the following:

- conducting engineering surveys or exploration;
- carrying out capital or current repair of infrastructure (for example, pipelines, high voltage electricity lines, etc.) or the reconstruction of federal, regional or local infrastructure;
- constructing temporary or support facilities or storing construction materials or construction equipment;
- placing temporary retail facilities and advertising structures, etc.

Complex development of public land

The amendments also affect existing regulation of land marked out for complex development, with the aim of creating an integrated approach to construction on public land. In general, the concept of complex development covers a set of actions performed by a private developer with the support of local authorities aimed at reclaiming a large amount of undeveloped public land (see Oksana Derevyanko, "Issues Relating to Complex Development Projects Under Russian Law" *Real Estate Gazette* (Issue 18, 2014) page 33 (hard copy) or page 58 (soft copy) for more on complex development projects in Russia). Such development generally includes: (i) preparation of the development concept (for example, construction of an industrial site with production facilities, residential buildings for its employees, etc); (ii) development of town planning documentation; (iii) formation of separate land plots, and (iv) construction of immovable properties on the newly formed land plots together with the infrastructure facilities necessary for their operation (roads, driveways, utilities, etc.). As a result, after construction is complete, the developed land should be fully provided with all facilities necessary for its operation; this is in contrast to high-rise development when a separate building is constructed near other facilities on already developed land.

Under the current land legislation, complex development is only applicable to the implementation of residential development projects. From 1 March 2015 the construction of manufacturing sites or logistics parks or indeed any other property will also be possible under the complex development procedure.

Potential impact of the amendments

The adoption of the amendments described above is aimed, first and foremost, at making the public land allocation procedure simpler, more efficient and clearer for all those involved in the development of land. However, the amendments do not contain regulations affecting or clarifications on all issues connected with the new procedure, and it may be anticipated that the implementation of the procedure will face a number of practical problems which will have to be resolved, in order for it to work.

AVOIDING STAMP DUTY BY MEANS OF CADASTRAL MEASURES

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Most real estate transactions in Sweden are made as direct transfers or through special purpose vehicles. For some time now, the number of transactions carried out by means of cadastral procedures have increased and in recent years, Sweden has experienced a further increase, in particular with regard to partitioning. The trend is apparent in the greater Stockholm area and the Öresund region, whilst the method is not at all common in other parts of Sweden, mainly because of lower property values there.

The reason for real estate transactions being performed by means of cadastral procedures of greater or lesser complexity is, of course, tax-driven. In Sweden, every direct transfer of real estate is subject to stamp duty. At the rate of 4.25 per cent of the purchase price or taxed value (whichever is higher) and 1.5 per cent for individuals, the amount of stamp duty levied can be significant for attractive real estate.

There are two main cadastral procedures used for commercial property transactions: reallotment and partitioning. It will come as no surprise to learn that the legislator did not create these cadastral procedures in order to facilitate the avoidance of stamp duty! On the contrary, reallotment is a method envisaged (and most commonly used) to create one plot of land out of two or more previously separate plots of land, and partitioning is merely a way of dissolving joint ownership of real estate. This article examines the two cadastral procedures and gives a brief overview of how a transaction by means of cadastral procedure may be structured.

Reallotment

The obvious situation in which reallotment could be carried out is where you have two parcels of real estate which would be more suitable as one unit. The two parcels must be located next to each other. The Swedish Cadastral Authority may, upon application, transfer the site of the first parcel into the second, thus creating one, larger parcel. The main requirement is that a land surveyor approves this transfer. Although the land owner giving up land is often compensated in the same way as would have been the case in a direct transfer, no stamp duty is levied on the reallotment. The cost of a cadastral procedure varies depending on its complexity, but if, for example, the Swedish Cadastral Authority charges approximately EUR 10,000 for the cadastral procedure, the value of the land in question and the compensation paid for it must exceed around EUR 235,000 in order for the transaction to benefit from a reallotment structure. Clearly then, most commercial transactions do benefit from a reallotment, should this be possible.

There are several ways of structuring a reallotment transfer. The most beneficial, and also most common, is if there can be found (or created through sub-division) a small and inexpensive parcel of real estate located next to the desired parcel. In these circumstances, the smaller parcel would be purchased by means of a direct transfer, and the bigger parcel transferred into the smaller, by means of reallotment. As many transactions today involve the purchase of large portfolios of real estate, it is always important to check whether the requirements for a reallotment could be met.

It should be stressed that there are factors other than stamp duty to consider before initiating a reallotment procedure. Risks relating to mortgage eligibility are significant (although there may be ways around that issue) and the procedure is often time consuming. An international investor is likely to be unfamiliar with the Swedish cadastral legislation and bureaucracy and there will always be a greater degree of uncertainty in such a transaction than is normally the case in a direct transfer. Therefore, it is recommended that the purchase agreement includes alternative methods of securing the sale, should the reallotment procedure fail. Specialist legal advice is essential.

Partitioning

Partitioning of real estate is mainly used as a means to dissolve joint ownership, often between relatives who have inherited the property, thus creating joint ownership. As noted earlier, partitioning has also become an instrument in commercial transactions, solely because the partitioning of land is exempt from stamp duty, whilst the more common method—sub-division—is not.

Partitioning of real estate should be considered when the asset involved in the transaction is a part of a larger property. Separation of the desired part of the property is most commonly achieved by means of sub-division, where an area of the property is separated from the residual property unit, and forms a new property. Sub-division is, however, subject to stamp duty. In order to partition the real estate instead, the purchaser must first enter into joint ownership of the property in question. This is accomplished by purchasing a (non-defined) share of the property, preferably as small as possible as this purchase will be subject to stamp duty. Once joint ownership has been achieved, the Swedish Cadastral Authority may, upon application from the owners of the different shares of the property (based on an agreement between them), use a partitioning procedure to divide the property into several new properties. Swedish law stipulates that the partitioning should be conducted taking into account each owner's share of the property and that compensation should be paid, should one party not receive a new property corresponding to its previous share of the whole property. However, these rules may be set aside if the parties agree, which means that a party may purchase as little as 1 per cent of the property, and then, by means of partitioning, end up with a much larger portion of land as a new property.

The complexity of cadastral procedures in Sweden means that a structured transaction by means of partitioning will require a considerable number of agreements, in particular with regard to joint ownership, which may last for between six and twelve months. Careful consideration should be given before entering into joint ownership of property for various reasons. For instance, the potential for qualifying for a mortgage is limited during the period of the joint ownership and for a short period of time thereafter. However, if time is not a concern and the relationship with the other potential joint owners is stable, there may be significant tax savings. As usual, specialist legal advice should be sought before initiating a partitioning transaction, as the Cadastral Authority is not likely to be helpful where the real objective of the partitioning procedure is tax avoidance.

Closing remarks

Although the potential for using cadastral procedures such as reallotment or partitioning as a method of avoiding stamp duty has been apparent for decades, the number of such transactions has been relatively low and the tax loss for the state negligible. However, the recent rise in the number of these transactions has prompted the Swedish government to announce measures to investigate whether there is a need to crack down on transactions whose sole purpose is to avoid stamp duty. It will not be an easy task to find the right legislative tools to clamp down on intended transactions without adversely affecting other cadastral procedures. It is predicted that we will continue to see transactions taking place by means of cadastral procedures and that the inherent complexity of the process will keep their numbers low enough for the legislator to deem the consequent tax loss to the state, if not negligible, then at least acceptable.

NEW LAW REGULATING RETAIL BUSINESSES

TUNAY YILMAZLAR, ISTANBUL

Following 10 years' heated debate on the subject, Law No. 6585 on the Regulation of Retail Businesses ("the Law") finally came into force on 29 January 2015. The details of the Law remain sketchy at present but the Ministry of Customs and Trade has announced that it will shortly be issuing a Regulation to provide more detail. In the meantime, this article outlines the provisions of the Law, and assesses its impact on the retail sector.

What is the purpose of the Law?

Article 1 of the Law states that its aims are: to facilitate the growth of new and existing retail operations; to ensure that retail businesses are operating in accordance with competition rules; to regulate the expansion of retail operations; and also to govern the relations between retail operators, manufacturers and suppliers.

The Law introduces an online retail information system (known in Turkey as "PERBIS") under the Ministry of Customs and Trade. Parties wishing to open a retail business are required to apply for an operating permit and if successful, will be granted a permit by the relevant local authority through PERBIS. The documents required and the procedure to be followed to make a successful application are to be set out in a forthcoming Regulation.

Construction permits for shopping malls

Before the Law came into force, the various district authorities were mainly responsible for the issuance of construction permits, under Zoning Law No. 3194.

However, Article 5/7 of the Law expressly provides that it is the metropolitan authorities that are the "relevant authority" for the issue of construction permits for shopping malls, if the particular shopping mall is within the borders of a metropolitan authority, such as Istanbul, Ankara, Izmir, etc.

As part of this new construction permit application procedure, the metropolitan municipalities will also take advice from third parties as to whether a construction permit for a shopping mall should be granted. The details of this process, and how it will operate alongside the online procedure on PERBIS, will be detailed further in the forthcoming Regulation.

Common areas of shopping malls and assignment of space at larger stores

Two new principles introduced by the Law relate to common area usage and assignment of space in a shopping mall, factors which affect both the shopping mall investors and the retailers.

Common area usage

Article 11 of the Law provides that at least 0.5 per cent of the sales area of a shopping mall must be allocated for social and cultural activities. The same article also requires shopping malls to provide common areas for facilities such as emergency medical service units, a prayer room, and a child care facility and playground. More details on these

requirements are to be provided by the forthcoming Regulation.

Assignment of space

Article 12/1 of the Law stipulates that at least 5 per cent of the sales area of a shopping mall is to be allocated to traders and artisans working within the mall. This space must be leased on the basis of market value. In the event that vacant spaces are not filled by traders and artisans within 20 days as of their becoming available, those spaces can then be leased to other parties.

Moreover, Article 12/2 of the Law states that at least 0.3 per cent of the sales area of a shopping mall is to be allocated to persons who are practising a profession which has traditional, cultural or artistic value, and which is in serious decline. The rent charged for leasing these areas cannot be more than 25 per cent of their market value.

In terms of the shelf assignment at the large and chain stores, Article 12/3 of the Law requires that shelves corresponding to at least 1 per cent of the sales area of a big store or a chain store must be assigned to local products. Again, more details of this provision will be given in the Regulation.

> At least 5 per cent of the sales area of a shopping mall is to be allocated to traders and artisans working within the mall.

Existing shopping malls and retailers

Under Provisional Article 1, the Law aims to protect the rights of existing shopping malls and retailers and it introduces the following requirements:

- Information relating to existing retail operators will be transferred to PERBIS within one year of PERBIS being up and running;
- Permits which have already been issued to retailers by the relevant district will still be valid and no further application to the metropolitan authorities will be required;
- Common areas defined under Article 11 of the Law must be put in place in existing shopping malls by 29 January 2016;
- Where existing shopping malls have vacant spaces, these must be leased by giving priority to traders and artisans, until the ratio of 5 per cent stipulated by Article 12/1 is reached;
- Similarly, vacant spaces within existing shopping malls must be leased to persons who are practising a profession with traditional, cultural or artistic value and which is in serious decline, until the ratio of 0.3 per cent stipulated under Article 12/2 is reached; and
- The requirements for shelf space for local products within large and chain stores prescribed under Article 12/3 must be met by 29 January 2016.

It should be noted that the Law also provides sanctions for existing or new shopping malls and retailers that do not comply with these provisions within the prescribed periods.

Lastly, the Law introduces new provisions on payments to be made to suppliers and others, details of which will be given in the Regulation.

Conclusion

It can be argued that although the draft Law provided more protection for traders and artisans, the final version of the Law, in fact, provides for protection for all parties. As noted at the outset of this article, many uncertainties remain under the Law, and it is hoped that the forthcoming Regulation from the Ministry of Customs and Trade will provide more detail on the provisions outlined above.

RIGHTS TO LIGHT—A NEW DAWN APPROACHING?

BEN BARRISON, LONDON

Introduction

Rights to light issues can have a significant impact on any development scheme in England. Neighbours can obtain court orders, known as injunctions, to prevent interferences with their rights to light and/or be awarded significant damages to compensate them for the loss of their rights. In some cases, these claims can destroy the viability of a development scheme or require it to be altered significantly.

Over the past 200 years, various statutes and cases have sought to clarify how and when rights to light can arise or be extinguished and/or what should be the appropriate remedy for interference with the rights—injunction or damages? If damages, how should they be calculated? Despite these efforts, the issue of rights to light remains an uncertain and usually highly contentious area of risk for most development schemes.

In an effort to address the problems, England's Law Commission undertook a detailed review of the law on rights to light. The Law Commission's final report was published in December 2014 and proposed significant changes to rights to light law, which are expected to be adopted by Parliament. This article considers the current problems posed by rights to light claims and the solutions proposed by the Law Commission.

What is an easement? A right benefiting a piece of land that is enjoyed over another piece of land owned by someone else.	**What is a right to light?** An easement to enjoy the natural light that passes over someone else's land, and then enters a building through apertures/openings such as windows (with or without glass), skylights and glass roofs.
How much light? Sufficient natural light to allow the room or space behind the relevant aperture/opening to be used for its ordinary purpose. The amount of light can depend on type of property and room.	**What is not covered by a right to light?** • A right to a view • A right to sunlight • A right not to be overlooked • A right to privacy However, many of the above are public law considerations for the grant of planning permission.

How can rights to light arise?	
Immediately: • Express grant • Implied grant • Statute	**Enjoyment over time:** • Prescription Act 1832—20 years' enjoyment "as of right" • Common law prescription • Doctrine of lost modern grant

Uncertainty, imbalance and more uncertainty

Developers must tread very carefully as to how and when they deal with the potential impact of rights to light claims on their scheme. The injunctions that can be awarded can result in the developer having to cut back their proposed scheme and/or stop work altogether. Thus the financial implications can be huge.

A neighbour who may be entitled to an injunction is under no constraints as to when it must issue proceedings for an injunction except that the courts will generally not assist a party who seeks an injunction after the event, if it can be shown that they had the opportunity to act sooner. Notwithstanding this general principle, there are examples in case law where a party has waited until a building has been erected and has then obtained an injunction requiring it to be cut back. These were extreme cases that show quite how much trouble an injunction can cause at any stage in a development project.

Given the nature of the threat posed by an injunction, neighbours can often extract favourable settlement payments from developers who may be prepared to pay to settle a claim rather than run the risks associated with court proceedings. With claims of this nature, the risks arising from court proceedings include the usual factors such as time and expense but also an additional layer of risk arising from the courts' discretion as to whether or not to award the claimant damages or an injunction. The case law provides some guidance for judges as to how this discretion should be exercised. Furthermore, recent Supreme Court discussion of the point suggests a flexible, proportionate approach that regards injunction as a last rather than first resort is to be favoured. However, the judge in each case retains a high degree of autonomy as to how to exercise discretion in that particular case. Therefore, until judgment is delivered, a developer may still face the risk that the court will order that its scheme be stopped.

Notwithstanding the problems for developers, neighbours seeking such injunctions should not do so lightly. Litigation relating to these injunctions can be very expensive and time consuming. Where a party seeks an interim injunction requiring the development to stop while the case is determined, the party requesting the injunction will

have to give the court an undertaking to pay for any losses suffered by the developer, if the court goes on to decide that an injunction is not the appropriate remedy. In the context of a development, the losses could be significant, so the neighbour may be required to provide security for its undertaking either by way of payment of a sum into court or a charge over its assets. Accordingly, the threat of an injunction should always be considered in the context of whether the process can be funded.

Current options for developers

Developers often deploy one or more of the following tactics as part of their rights to light strategy:

- Negotiations to achieve early settlement and the release of future claims;
- Light obstruction notices;
- Rights to light insurance; and/or
- Developer-led litigation to determine the existence of the rights to light and the appropriate remedy.

A negotiated solution will provide certainty for the developer at an early stage. It may in some cases involve paying more than the claim is "worth" but it does eliminate the risk.

Light obstruction notices are statutory notices that can be served to prevent a neighbour claiming rights to light based on 20 years' continuous enjoyment as of right. If these remain unchallenged for 12 months, the neighbour's claim based on 20 years' enjoyment is eliminated. As well as eliminating claims, these notices can be a useful way to "flush out" potential claimants. However, they can have unintended consequences as they may alert parties to their potential rights.

In the past few years, rights to light insurance has become more and more popular. As with all insurance, it does not prevent the problem arising but provides comfort in the event that it does. Since negotiations and light obstruction notices can take time that is sometimes not available to a developer, many parties now regard rights to light insurance as a viable alternative to negotiated solutions and light obstruction notices.

Developer-led litigation can be appropriate in circumstances where the neighbour's claim lacks merit but the party is still seeking to extract damages using the threat of injunction. It is an option that should be deployed very carefully.

The Law Commission's proposals

There are two significant changes to the law being proposed by the Law Commission:

1. *A statutory test of proportionality for the courts to use when deciding whether injunction or damages is the appropriate remedy.* The recommendation is that a court must not grant an injunction to restrain the infringement of a right to light if doing so would be a disproportionate means of enforcing the dominant owner's right to light taking into account all of the circumstances, including:
   - the claimant's property (for example, whether it is residential or commercial);
   - the loss of amenity attributable to the infringement including the extent to which artificial light is used at the property;
   - whether damages would be adequate compensation;
   - the claimant's conduct;
   - whether the claimant delayed unreasonably in claiming an injunction;
   - the defendant's conduct;
   - the impact of an injunction on the defendant; and
   - whether the scheme is in the public interest.
2. *A Notice of Proposed Obstruction (NPO) procedure by which a developer can put its neighbours on notice as to the proposed development.* Following service of the notice, the neighbour must issue injunction proceedings within eight months otherwise it will only be entitled to claim damages for any interference with its rights to light.

Since the proportionality test is very similar to the approach commended by the Supreme Court in *Coventry v Lawrence*, it seems highly likely that the courts may be inclined to adopt a similar test in upcoming cases even if the adoption of the test is presented as part of the courts' general consideration as to how to exercise their remedial discretion. This may mean the courts are less likely to award injunctions in the future but developers should remain vigilant as there are a number of criteria for the courts to apply and the existence of artificial light and planning consent are unlikely to tip the balance in favour of damages in every case.

Once adopted, the proposed changes should enable developers to manage rights to light risks with greater certainty. Some industry commentators have suggested that the NPO procedure should be regarded as a last resort in the event that negotiations fail as it can appear to be aggressive. However, it seems to this author that, if and when available, the NPO may in fact be a sensible step for developers to take at an early stage so they can establish which neighbours are in fact going to seek injunctions and which will settle for financial compensation.

Conclusion

While we await the introduction of the recommendations, parties must continue to deal with rights to light matters under the current regime and take care to engage a proper and effective rights to light strategy. Different schemes require different strategies. The key is to be vigilant, aware and flexible.

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