INTERNATIONAL *REAL* ESTATE FINANCE & INVESTMENT REVIEW 2023/24



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The International Real Estate Finance & Investment Review 2023/24

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FOREWORD

The real estate market in 2023: hold tight before shaking the tree

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BIO

Bernat Mullerat is a partner at the Corporate and Real Estate Practice Groups of CUATRECASAS in Barcelona, Spain.

He has advised on many real estate transactions, mainly acquisition of shopping centres, hotels and office buildings, as well as hotel and tourist resort management. He advises on regulatory and contractual matters related to tourist and timesharing transactions. He also handles national and international transactions to develop and sell renewable energy projects.

He is co-chair of the Real Estate Section of the International Bar Association (2022-2023).

He was vice-chair of the British Chamber of Commerce in Spain (2005-2010) and senior vice-chair of the Environment, Health and Safety Law Committee of the International Bar Association (2008-2010).

He speaks regularly at national and international seminars and conferences on real estate and the environment.

He is the author of several law review articles on Spanish real estate and environmental law.

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The real estate market in 2023: hold tight before shaking the tree

Real estate is an ever-changing market, influenced by a myriad of local, regional and global factors.

2023 is proving to be a year of uncertainty. Almost two years after the end of COVID-19, the world and the real estate market with it are still endeavouring to find the new normality. The pandemic and geopolitical and economic issues (such as the invasion of Ukraine, the emergence of China as a superpower and the high inflation), streamlined a deep transformation of the real estate industry, which ultimate results are difficult to predict.

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> Slower economic growth, or even mild recession, and more expensive capital bring about a time of uncertainty as the foundations of the economy are still unclear.

COVID-19 brought significant changes to the way we work which were expected to last long. Working from home seemed to get a stronghold across the board, while two years later many corporates, large and small, are pushing back into the office more like in 2018. Similarly, business travel and conferences faded as if they would never come back the same, but they are now recovering strongly.

Slower economic growth, or even mild recession, and more expensive capital bring about a time of uncertainty as the foundations of the economy are still unclear. Below are some key market trends that are shaping the real estate industry:

- **Price correction** continues to unfold as buyers and sellers do not agree on pricing.
- The uncertainty surrounding **monetary policy** and **tighter credit conditions** sink real estate deals.
- **Distressed real estate transactions** have become common place due to high interest rates and increased debt servicing costs. Distressed properties in need of debt restructuring have lured a plethora of investors looking for opportunities and raising capital to acquire defaulting property backed loans.

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- **Quality of assets**, whether through new construction or refurbishment, will continue to be a safe harbour.
- Record home prices and high construction costs have resulted in a **global housing shortage**.
- **ESG** shifts from an ancillary tick in the box to a core element in investment and management decision making. Investors, owners and occupiers are now seeking greater ESG disclosure.
- Opportunities arise when shifting into **new asset classes**, such as student accommodation, senior living, data centres and healthcare.
- The **impact of climate change** on real estate has accelerated in recent years and become more acute. Extreme weather and climate phenomena have brought a sense of urgency on the multifaceted measures to be taken. McKinsey & Co. suggest three actions to navigate the climate transition: (i) incorporate climate change risks into asset and portfolio valuations, (ii) decarbonise real-estate assets and portfolios and (iii) create new sources of value and revenue streams for investors, tenants, and communities.
- **Technology** is playing a major role in the property industry. PropTech tools are increasingly present on all layers of the business. From virtual and augmented reality to facility property shows, to artificial intelligence to find and analyse deals, including smart building management systems. PropTech will change how people buy, sell, rent, occupy and manage property.

We are living a time of deep transformation in the global economy and the real estate industry. Time to steady the direction and set the fundamentals of a healthy industry. It is precisely in this environment when opportunities arise for the bold, wise and creative players, including lawyers.

AUSTRALIA
Debt Funds Options—NHFIC and Alternatives

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BIO

Jennifer McCosker has advised a number of Australia's leading commercial property financiers, investors and developers on a wide range of transactions, including large-scale property and development finance matters and the sale and acquisition of commercial, retail, industrial and mixed-use properties. She has also acted for clients on complex property development and construction projects, as well as commercial and retail leasing matters.

Well known for her commercial approach, a client is quoted saying Jennifer's cross-border experience sets her apart in the industry and enables her to adeptly service global institutions (in both private equity and debt capital markets) when directing their real estate investments into Australia.

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BIO

Alan Maclean has over 30 years' experience as a banking and finance lawyer and acts for domestic and international banks, financial institutions, non-bank lenders, corporate borrowers and sponsors across a broad range of finance transactions. He has deep experience in property finance, corporate finance and acquisition and leveraged finance and also has considerable experience in asset finance and insolvency, workouts and restructures.

Alan's experience extends to all facets of development and investment financing in the commercial property market acting for senior and mezzanine financiers and developers. He has been involved with the financing of industrial subdivisions, apartment towers, commercial office buildings, multi-use developments, listed and unlisted property funds, hotels and other serviced accommodation.

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Debt Funds Options—NHFIC and Alternatives

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Australia is currently experiencing a national housing crisis. There is a gap between supply and increasing demand, affordability is slipping further out of the reach of younger Australians with high house prices, interest rates and inflation are outstripping wage growth, and there are growing rental market pressures with record rent escalations.

Historically, 'build to own' has been the prevalent model in Australia for large-scale residential developments, in which a property developer builds an apartment complex and sells the units to individuals, who will either choose to live in them or rent them out as investment properties.

Investment in build to rent (BTR) residential developments (otherwise known as 'multifamily housing' internationally) is being driven by community and government demand, tax and other government incentives, longer term returns, and lower maintenance costs and incentives compared to office or commercial developments.

To date, institutional investment in the residential market in Australia is a fraction of that compared to some other countries.

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> Historically, 'build to own' has been the prevalent model in Australia for large-scale residential developments.

For example, in Australia, institutional investment totals just 3% of funding, whereas in the United States and Germany, it is closer to 35%. The size of the BTR sector as a percentage of the residential market as a whole tells a similar story. In Australia, it is just 0.2% compared to 5% in the United Kingdom and 12% in the United States.

However, rental housing demand has been on the increase in Australia, with a shift to long-term renting. The twin factors of high demand and constrained supply means that in the foreseeable future, it is unlikely that home ownership will become more affordable in Australia or that the shift to long-term rentals will abate. Rather, it is anticipated that the shift to the permanent rental market will only grow stronger.

These factors, supported by the improved amenity (including from curated or green spaces in new projects) and additional landlord security benefits that high-quality BTR assets offer, suggest that BTR assets have a genuine and desirable role to play within modern Australia. BTR assets also have the benefit of accelerated supply to the market due to the removal of presale requirements.

Funding for BTR residential developments takes many different forms and is generally provided by private sector investors or financiers, governments or government authorities, or a combination of the two.

However, funding will only be provided by the private sector if the income streams from the development are secure and the post-tax returns meet market expectations. Equally, funding by governments or government authorities will usually be linked to set eligibility criteria, including environmental and sustainability standards, affordable rents and places, certainty of tenure, and communal amenities and services.

We examine below various funding models and the different risks of funding or investing in the BTR sector.

Direct Lending Debt Finance

BTR developers are finding ways to secure debt funding as Australian lenders become more familiar with this asset class. Whilst historically the 'Big Four' banks have not demonstrated a significant amount of interest in this sector, this is starting to shift as bankers familiarise themselves with the risks of this asset class.

Nonbank lenders provide an alternative to traditional bank financing as they generally offer more flexible terms to support the project. Return hurdles may be an issue, however, given the cost of debt from nonbank lenders.

Typically, BTR facilities are structured as either bilateral or syndicated loan facility agreements. Some syndicated facility agreements take the form of loan note subscription facilities with the notes being offered so as to satisfy the 'public offer test' under section 128F of the Income Tax Assessment Act and for any interest payments to nonresident noteholders to be exempt from interest withholding tax.

Community Housing Providers and NHFIC

National Housing Finance and Investment Corporation (NHFIC) is a corporate Commonwealth entity with the purpose of improving housing outcomes for Australia. In particular, NHFIC encourages investment in the social or affordable housing sector and provides loans, investments, and grants that support Commonwealth, state, or territory activities relating to housing. It has played a pivotal role in providing funding to developers to support the BTR initiative.

NHFIC manages the AU$1 billion National Housing Infrastructure Facility, which offers concessional loans, grants, and equity funding to help support critical housing enabling infrastructure.

Through the Affordable Housing Bond Aggregator (AHBA), NHFIC also provides low cost, longer tenor loans to registered community housing providers to support the provision of more social and affordable housing. NHFIC funds AHBA loans by issuing social bonds into the wholesale capital market with the benefit of a Commonwealth guarantee.

In addition, NHFIC provides grants of up to AU$20,000 to all registered community housing providers.

The funding regimes implemented by the Australian government are similar to the models employed in the United States. In the United States, grants or low-interest loans are provided to developers to encourage the development of low-income housing. For example, close to half of all multifamily mortgage debts in the United States are said to be backed by US federal government agencies such as the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Government National Mortgage Association (colloquially known as 'Fannie Mae', 'Freddie Mac', and 'Ginnie Mae', respectively). These organisations are committed to sustainable financing for affordable housing.

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> NHFIC manages the AU$1 billion National Housing Infrastructure Facility.

Developer Funding Model

Another funding model is for developers to own, fund, and develop the BTR project by way of joint venture, partnership, or co-ownership arrangements. Funding is provided by way of equity or debt funding regulated by joint venture agreement, partnership agreement, or co-ownership agreement as applicable. All critical contracts, such as finance, construction, operator, and tenancy agreements for the project, are entered into by the developer entity.

Investor Funding Model

Another funding model is for an investor or investors (through a fund or trust) to own the BTR project. Funding is provided by way of equity or debt funding sourced by the investor. All critical contracts, such as development, operator, and tenancy agreements for the project, are entered into by the investor entity. Generally, the developer arranges construction of the project and enters into the construction contract.

Managed Investment Trusts

Where the investor entity under the investor funding model is a managed investment trust that has foreign investors, a reduced withholding tax rate of 15% will apply from 1 July 2024; however, there are potential traps that may apply in qualifying for such a reduction. Australia also has new thin capitalisation rules, which are to apply from 1 July 2023 and may limit the availability of debt deductions for MITs and other investment property trusts.

Key Risks of BTR Funding Models

There are several obstacles that developers are currently facing when trying to secure debt funding.

BTR projects do not have long term lease commitments and utilise short lease terms which may not be extended or renewed. This poses difficulties in the lending credit approval and underwriting process—financiers require contractual certainty as to future payment streams.

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> Lenders regularly assess land acquisition and construction risks for build to sell projects and the same risk mitigants will apply.

Many lenders are hesitant to provide funding to developers without a proven track record of success in the BTR market as it is a relatively new asset class. Additionally, there is little historical data with respect to valuations for BTR projects which provides financiers with less certainty.

This has led to lenders adopting a more conservative approach to loan to value ratios and requiring developers to provide greater equity than for build to sell projects.

Lenders must assess the risks of BTR projects during four distinct phases:

1. Land acquisition and early works
2. Construction
3. Preleasing and launch
4. Operation and occupation

Lenders regularly assess land acquisition and construction risks for build to sell projects and the same risk mitigants will apply, such as loan to value and loan to cost covenants, quantity surveyor reports, builder expertise and capability assessment, builder's side deeds, key development and management agreement tripartite deeds, cost overrun undertakings, builder bank guarantees and adequate insurance coverage.

If the lender is committing to provide funding beyond practical completion of the project, it may provide separate construction and operations tranches with specific conditions precedent, which must be satisfied to transition from the construction to the operations tranche. These conditions may include:

1. Evidence that practical completion of the project has occurred
2. Preleasing commitments and total rental levels have been reached
3. Acceptable as complete (with leasing commitments) valuation
4. All body corporate amenities are fully operational
5. Rental account and service account in the control of lender
6. Approved leasing agent
7. Initial compliance with new operations phase financial covenants (e.g. debt service or interest cover ratios, forecast and actual net income tests, loan to value ratio, weighted average lease expiry covenant or maintenance capex undertaking)
8. Initial leasing report from the leasing agent

Lenders will usually require amortisation of the loan during the operations phase and will set a repayment schedule based on forecast leasing and net rental income levels.

Depending on the level of leasing precommitments achieved, lenders may require rental guarantees or other incentives from developers to attract leasing commitments.

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Exit strategies for lenders during the operations phase include any combination of the following:

1. Conversion of rental lots to sale lots
2. Refinancing by another lender or fund
3. Division of project into separable portions which can be separately refinanced, sold or leased
4. Take out by equity investors
5. As a last resort, enforcement and sale as a going concern

Lenders will pay particular attention to the developers, managers and operators of BTR projects as they recognise that strong development and operational management is required for BTR assets to be successful. Tripartite agreements which allow for cure and step in rights are a central part of the lender's security package.

Some other important considerations for lenders and investors may be Foreign Investment Review Board, heightened government compliance standards and reporting requirements where green lending principles are involved, affordable housing incentives are being provided to the project or lots in the project are being leased to registered community housing providers.

Missing Piece of Puzzle

Ultimately, BTR projects may be the missing piece of not only the affordable housing puzzle but also the national housing shortage. Critical to this however is the ability of developers to obtain investor funding from domestic and offshore investors and for the debt funding market for this asset class to expand and mature.

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Some other important considerations for lenders and investors may be Foreign Investment Review Board.

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BIO

Norman Klein is the Office Managing Partner in the Cayman Islands.

Over the past 25 years, Norman has acted for the developer, lender, seller or purchaser of every significant hotel/resort property in the Cayman Islands. His practice includes property development, commercial acquisitions and dispositions, financing transactions and commercial and retail leasing. He has particular expertise and experience in the areas of hotel, condominium and commercial development, financing and restructuring for local and international clientele. He has also advised developers (and prepared agreements) with respect to many of the most significant development and construction projects in the Cayman Islands.

Norman is ranked as Band 1 by Chambers Global describing him as "a leading light in the field of real estate". The Legal 500 rankings identify him as a 'leading individual' annually, year on year, and Legal 500 Caribbean has described him as being "knowledgeable and accessible" with "particular experience in the areas of hotel, condominium and commercial development."

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BIO

Adam is a Partner in the Corporate and Property practice groups at Appleby.

He has a wealth of experience across multiple disciplines, including: all aspects of commercial and residential real estate acquisition, finance, development, leasing and disposal; corporate banking; whole loan portfolio transactions; project finance; M&A; outsourcing; and other major commercial transactions.

Adam is ranked as a Band 1 real estate lawyer in Chambers Global, with sources praising his "outstanding reputation" and referring to him as "honestly one of the most efficient, proactive and supportive lawyers I have come across". Legal 500 has ranked Adam as a "Next-Generation Partner" since 2020, describing him as "second to none in terms of knowledge, commerciality, and his rapport with clients" and "incredibly knowledgeable and responsive".

In addition to his legal practice, Adam leads the real estate module of the Truman Bodden Law School Professional Practice Course, gives seminars on business development strategy on behalf of the Caymanian Bar Association.

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CAYMAN ISLANDS REAL ESTATE FINANCE & INVESTMENT OUTLOOK 2023

The Cayman Islands, known for its natural beauty and tax neutrality, have long been a sought-after destination both for investors looking to diversify their portfolios through real estate and high-net-worth individuals looking to relocate on a permanent or semi-permanent basis. In 2023, the Cayman Islands continue to offer attractive opportunities for real estate finance and investment. This article explores the current state of the Cayman Islands' real estate market (post second quarter market trends), the factors driving investment, and the considerations that make Cayman an appealing choice for investors.

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> In 2023, the Cayman Islands continue to offer attractive opportunities for real estate finance and investment.

THE LATEST - CAYMAN REAL ESTATE 2023 – SECOND QUARTER MARKET TRENDS

Cayman's real estate market remains robust in 2023, with steady demand for both residential and commercial properties. Key factors contributing to this stability include:

- *Steady Economic Growth*: The Cayman Islands have maintained a strong and stable economy, driven by the financial services sector, tourism industry, and a favourable business environment. Historically, Cayman real estate has remained stable over the last decade and soared to record high sales since the height of the COVID-19 pandemic in 2020.

- *Tourism and Expat Community*: The islands' thriving tourism industry and a growing expat community contribute to the demand for investment rental properties.

- *Tax Advantages*: The Cayman Islands offer a tax-efficient environment with no ongoing property taxes[1], capital gains tax, or income tax. This makes real estate investments in the region even more attractive to international investors.

- *Political and Economic Stability*: The Cayman Islands have a history of political and economic stability, closely linked with its status as a British Overseas Territory, which is crucial for maintaining investor confidence.

- *Leading Offshore Financial Services Sector*: With its multi-decade reputation as a leading provider of services to the financial services sector, the Cayman Islands is a very attractive jurisdiction for banks, trust companies, law firms and insurance service providers (to name a few), meaning that international organisations and their high performing professionals continue to relocate to, and maintain a presence within the islands, thus increasing the demand for commercial and residential space. This in turn drives investment in critical infrastructure such as transport and healthcare in addition to ancillary amenities, further increasing the desirability of the jurisdiction.

- *Airlift*: The proximity of the Cayman Islands to North America, together with recent expansion to the Owen Roberts International Airport and a growing availability of direct flights, means that travelling to the Cayman Islands has never been more convenient.

1. The Cayman Islands Government imposes a one-off stamp duty charge for real estate transactions (an ad valorem rate that depends on the nature of the transaction) and minor registration fees. However, there are no ongoing real estate taxes.

The local real estate market has continued to produce strong sales and price results over the last twelve months. However, the second quarter of 2023 has shown that property values are remaining stable despite increased carrying costs (insurance premiums and financing costs primarily), albeit a reduction in the speed of transactions seen during the post-pandemic boom. These increased costs, which are not unique to the Cayman Islands, have primarily impacted the low-to-mid end of the market where in respect of properties for sale below US$2M and sales activity in general, year to date deal volume has decreased by 26.43% in comparison to 2022[2].

While increased costs undoubtedly impact many, decreased deal volume can also be explained by the low supply to high demand ratio for Cayman Islands real estate – the post-pandemic boom, which when coupled with longer lead times for completing new development projects as a result of global supply chain issues, has led to an imbalance of willing sellers and willing buyers. For example, as of July 1st 2023, 1,952 active listings were reported on the market (this figure includes those that were or are under offer)[3], which is 6.79% fewer than in July 2022[4]. The continuation of imbalanced supply and demand underpins recent price performance in the market.

Demand for commercial property has also been relatively strong, with the jurisdiction's largest developers in this space either recently completing or breaking ground on new projects. Proposed revitalisation of the capital, George Town, received a significant boost following the announcement of One GT, a new mixed used tourism, residential and commercial development, which is a first for the area.

LEGISLATIVE FRAMEWORK

The Cayman Islands has maintained a centralised land register based on the "Torrens" system of registration. This results in a relatively safe, secure and predictable way of protecting title and largely avoids the need for expensive title insurance and lengthy title investigations compared with some jurisdictions which, when coupled with a sophisticated market of real estate and legal professionals, helps underpin investor confidence and reduce transaction costs.

In addition, several options are available to organise larger developments into a cohesive whole – one can either two-dimensionally or three-dimensionally subdivide a large parcel into several smaller parcels or stratify a development so as to provide for a vehicle to deal with collective interests, in each case imposing a framework of easements, covenants and/or (in the case of strata) by-laws so as to grant rights and impose obligations (including in respect of common areas). Three-dimensional subdivision, known as volumetric subdivision, is a relatively new legal mechanism perfectly suited to governing large multi-use developments (and/or dealings in airspace). As the nature of projects in the Cayman Islands continues to evolve, this more flexible and sophisticated mechanism is increasingly being used.

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The local real estate market has continued to produce strong sales and price results over the last twelve months.

The Cayman Islands Land Registry continues to work to implement e-conveyancing, and plans to implement a number of legislative initiatives to further streamline the land registration process. This is coupled with additional longstanding proposals by the Cayman Islands Government to modernise the 1997 Development Plan, and new proposals to enhance the protection afforded to borrowers as regards enforcement of borrowing secured by Cayman Islands real estate.

2. Source: Cayman Islands Real Estate Brokers Association ("**CIREBA**")
3. Source: CIREBA
4. Source: CIREBA

A recent significant development of interest to the international community would be the positive strides that Cayman has made to be removed from the Financial Action Task Force (**FATF**) "grey list". After a meeting in Paris in June 2023, the FATF confirmed that the Cayman Islands would be eligible for removal from the list after performing a final visit to verify ongoing progress of the action plan that was set out by FATF. The task force met with government officials, regulatory authorities, and private sector entities to gain insights on the jurisdiction's robust regulatory framework.

SEVEN MILE BEACH

Any commentary on Cayman Islands real estate would be incomplete without specific attention being drawn to the highly desirable Seven Mile Beach. Famed for its sparkling waters and coral sands, this award-winning[5] shoreline is home to some of the Caribbean's most luxurious properties and attracts travellers from all over the world.

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> Any commentary on Cayman Islands real estate would be incomplete without specific attention being drawn to the highly desirable Seven Mile Beach.

As such, premium seafront condominiums continue to sell quickly at increasing prices, and resorts continue to report strong RevPAR performance.

Lacovia

The US$350M Seven Mile Beach Lacovia re-development has obtained the official green light and works are to commence imminently. A leading engineering group with a track record of constructing some of the most challenging and complex projects in the world will oversee what is anticipated to be one of the newest and most luxury developments to hit the Seven Mile Beach are in the last decade.

The Lacovia development will encompass ultra-high-end modern luxury architecture with fourteen floor plans ranging from three to eight-bedroom apartments all designed by Swedish architects, OOAK. Sales for the development have been strong with a select few remaining units priced between approximately US$5.5m-US$30m.

Westin Grand Cayman Resort & Spa

The owners of the Westin Grand Cayman Resort & Spa have recently been granted planning permission to expand the resort to include a new ten-story hotel block with 234 guest rooms, a state-of-the-art conference centre and a suite of new restaurants, wellness facilities, pool, and rooftop bar. The existing resort was built between 1994 and 1999 and currently includes 343 guest rooms.

The Watermark

The Watermark is the latest ultra-high-end residential project by one of the jurisdictions most established developer of premium residences, which is anticipated for completion in 2024. The development brings top-notch amenities from the International Property Award-winning team behind the existing Watercolours development and is set to include luxuries such as a full-service spa, beachfront conservatory and wine storage lockers. The remaining units available are listed for approximately US$9.1m-US$14m.

Grand Hyatt Grand Cayman

This new five-star resort is under construction on the south end of Seven Mile Beach with an estimated completion in 2025. The Grand Hyatt is slated to be Cayman's second five-star resort after the Ritz-Carlton Grand Cayman. The resort promises to feature multiple pools, an ocean lagoon, 6 restaurants, spa and fitness facilities and a retail shops. Remaining available residences range from studio suites starting at US$950,000, up to three-bedroom spacious apartments topping out at around US$8M.

Hotel Indigo & Hampton by Hilton

Cayman's largest developer, Dart, is approaching completion of the first Hotel Indigo in the jurisdiction. Hotel Indigo sits under the IHG hotel chain umbrella and promises to offer a unique boutique hotel experience with modern amenities across the 282 guest rooms.
Dart also recently completed extensive renovations and rebranding of the Hampton by Hilton Grand Cayman, the first Hilton branded hotel to become operational in the Cayman Islands.

5. Seven Mile Beach has been named one of the "Ultimate Beaches" in the region by Caribbean Travel + Life, the 4th "Best Beach in the Caribbean" by Trip Advisor, and the 12th "best beaches" in the world by MSN. Source: Cayman Islands Department of Tourism

Kailani, Curio Collection by Hilton

Leading developer of Cayman Islands real estate, NCB Group, continues construction on the Kailani, Curio Collection by Hilton, a boutique wellness resort and residences located on the south end of Seven Mile Beach. This project is the first of its kind in the jurisdiction with significant emphasis being placed on sustainability and wellness.

Several other premium residential and tourism developments are underway or have received approval, located on or near to Seven Mile Beach. Arguably the most exciting of which is the Mandarin Oriental Grand Cayman, an expansive luxury resort and residences. This project attracts significant attention due to its size, promised quality and its status as the first Mandarin Oriental that is to be launched in the Cayman Islands.

The picture painted by the many examples that can be cited is one of confidence, growth and increasing sophistication in and of Cayman Islands real estate.

CAYMAN AS AN INVESTMENT IN 2023

Luxury Residential Real Estate

In two separate 2023 Global Wealth Reports by Knight Frank and Boston Consulting Group, Cayman was included as a notable jurisdiction for the annual change in luxury residential prices in 2022 as well as a top 10 private banking booking centre, respectively[6]. Knight Frank reported that the Cayman Islands had a 10% increase in the annual change in luxury residential prices in 2022 putting Cayman on par with St. Moritz, Cannes and Verbier (all also recording 10% increases)[7]. On the face of it, investors may chalk this up to a 10% luxury investment hike in potentially a sun or ski destination, however it can be agreed that this report further solidifies Cayman real estate assets as strong investments. Additionally, cross-border wealth rose by 4.8% in 2022, reaching $12 trillion globally[8]. This cross-border investment pushed Cayman into the ninth largest booking center globally amassing $0.5 trillion in 2022[9].

Investing in Cayman Islands real estate can also facilitate qualification for permanent residence, naturalisation and even Caymanian status, which makes investment attractive for those wishing to reside permanently or semi-permanently in the jurisdiction.

Commercial Real Estate

Within the two-year span since the COVID-19 pandemic, commercial real estate is in high demand in Cayman despite the transitions in workplace environments globally where working from home became and remain for many the norm.

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The picture painted by the many examples that can be cited is one of confidence, growth and increasing sophistication in and of Cayman Islands real estate.

An early 2023 report from Knight Frank revealed that real estate was playing a crucial role in supporting business transformation[10], which aligns with the increasing demand for Class A office space in the Cayman Islands.
In the urban town of Camana Bay, located on 685 acres along the Seven Mile Beach corridor, is located 858,000 square feet of this prime Class A office space. Much of the demand stems from existing players looking to expand business in Cayman as well as new entrants seeking to establish a place of business in the jurisdiction.

6. Source: Knight Frank – The Wealth Report 2023, BCG Wealth Report 2023 – Resetting the Course
7. Source: Knight Frank – The Wealth Report 2023
8. Source: BCG Wealth Report 2023 – Resetting the Course
9. Source: BCG Wealth Report 2023 – Resetting the Course
10. Source: Knight Frank Cresa Corporate Real Estate Index

The Cayman Islands Monetary Authority has reported that the number of registered funds within the Cayman Islands has grown to 29,092 in quarter one of 2023[11]. This transpires to a 168% increase since 2019[12]. In terms of these statistics relating to Cayman as an investment opportunity – more businesses on a multitude of spectrums have flourished, including fund administrators, fund governance providers, law firms, and audit firms. Additional investment has also arisen from the global regulatory requirement for companies to have a physical presence in the jurisdiction in which they are operational.

Notable Laws

Notable areas of the law that investors should consider include the Registered Land Act (2018 Revision), the Development and Planning Act (2021 Revision), the Strata Titles Registration Act (2013 Revision), the Stamp Duty Act (2019 Revision), the Immigration Act (as revised) and the Immigration (Transition) Act (2022 Revision). However, there are other laws that may be applicable, depending on the specifics of the transaction (such as the type of purchaser, the type of property and what activities the purchaser intends to carry out from the property).

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> Cayman Islands companies and foreign companies are the most common entity types and acquisition structures that investors use for real estate investment in Cayman.

There are generally no restrictions on foreign ownership of real estate in the Cayman Islands, although certain requirements may apply to different types of purchaser and use (such as the carrying on of business from within the jurisdiction).

It is always advisable to consult with a professional at the outset of a transaction in order to ensure that the investment would meet objectives and so as to understand applicable legal requirements.

Investment Structures

Cayman Islands companies and foreign companies are the most common entity types and acquisition structures that investors use for real estate investment in Cayman.

Considering that the Cayman Islands is a no-direct taxation jurisdiction, and real estate investment activities can be conducted though different structures, foreign investors are often select their investment model based on factors not driven by Cayman regulation.

11. Source: Cayman Islands Monetary Authority
12. Source: Cayman Islands Monetary Authority

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HONG KONG

Post-Pandemic Trends and Response from Hong Kong Real Estate Market

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BIO

Polly Chu is a senior partner at Withers' real estate team.

She has extensive experience in all aspects of real estate-related transactions including conveyancing, project conveyancing, development and redevelopment, financing and re-financing, mergers and acquisitions, property joint ventures, disposals and tenancy matters in respect of commercial, residential and industrial properties. She has advised a number of international renowned corporations in their retail leases for flagship stores, branches, shops-in-shops and outlets and strategic restructuring in the Asia-Pacific region including the PRC, Hong Kong, Macau, Taiwan and Singapore.

Polly has advised on legal matters including legality and potential issues via electronic signature for buying and selling of properties and in typical corporate transaction, conversion of and title issues for development of data centre or logistic centre; reviewing digital property management and facilities contracts; real estate crowd funding and banking facilities; and advice involving loans, trade finance products and working capital facilities granted for purposes of financing green activity.

Polly is a recognised practitioner in Real Estate (International firms), Asia-Pacific and Greater China Region Guide by Chambers and Partner 2019-2023.

Post-Pandemic Trends and Response from Hong Kong Real Estate Market

withersworldwide

As Hong Kong returns to some semblance of normality after the lifting of the COVID-19 restrictions and re-opening of its borders internationally and with Mainland China, a cautiously optimistic sentiment in the local real estate market emerges with the Government's roll out of several initiatives to stimulate local, tourist spending and investment appetite. As the city steps into Q4 of 2023, the market performance has begun to pick up its momentum and shows signs of improvement, although the progress differs across sectors in Hong Kong. Observing the recent market trends, the impact of interest rates and the macro and microeconomic environment, we are cautiously optimistic about Hong Kong's real estate market in the coming 6-12 months and have confidence that the investment activities and appetite will bounce back quickly once the uncertainties and risk factors become clearer.

Retail Sector More Promising Than Offices

The retail sector has benefited most from the recovery of the pandemic. It is the only sector showing positive growth since the border reopened in Q2 of 2023, predominantly due to the return of mainland Chinese tourists to the city and are big spenders primarily in luxurious brands and products such as jewellery, watches and gold. During the Golden Week in October, there was a substantial influx of mainland tourists which reached 85% of pre-Covid levels. Offset by an increase in outbound travel of local residents, retail sales have taken some time to recover but are gradually improving.

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> The economy revival brought less significant growth in terms of occupancy rate and rental levels for offices.

The Government's initiatives to roll out consumption vouchers after the border reopening and the launch of the nightlife campaign at the harbourfront are all welcoming measures to stimulate local spending.

A reboot of the retail property leasing market is spotted with a reduced vacancy rate of retail spaces in high street locations and rent increase. A few notable transactions include: (i) The Macallan, a world-renowned whisky brand that opened its first global flagship store spanning across two floors (8,519 sq ft) in Queens' Road Central for a monthly rent of HK$600,000; (ii) Chanel committing to an 18,000 sq ft space at Capitol Centre in Causeway Bay for a monthly rent of between HK$2.5 million and HK$4 million; (iii) a 818 sq. ft ground floor retail unit at 45 Haiphong Road, Tsim Sha Tsui, being leased to a pharmacy for HK$300,000 per month; and (iv) a 75,000 sq. ft retail unit comprising of three floors in Silvercord, Tsim Sha Tsui being rented by a restaurant and entertainment group for HK$5 million a month. An apparent acceleration of the leasing of retail spaces in the high street and core luxury mall locations, with committed leases mostly on the standard two-to-three-year terms, compared to the short-term leases that dominated the market during the pandemic, has helped improve the retail investment market sentiment.

Evolving Office Demand

The economic revival brought less significant growth in terms of occupancy rate and rental levels for offices. According to Jones Lang LaSalle's monthly market report in September, the overall vacancy rate shows signs of stabilizing at a flattened rate of 12.8% at the end of August and is expected to sit at 12.6% by the end of this year,[1] although still at the highest level since 1990s. The pandemic has significantly reshaped the office dynamic in Hong Kong. There is a notable trend in office downsizing and relocating to decentralized districts with consolidated spaces but an increasing overall demand for office upgrades. Co-working spaces and Grade-A premium office premises with green and technological facilities are becoming more popular. The new supply of around 3.2 million square feet of new Grade A office spaces this year will allow tenants to take advantage of the expected downward trend in rental and accelerate

1. https://www.jll.com.au/en/trends-and-insights/research/new-builds-help-to-revitalize-the-hong-kong-office-market

their relocation decisions. For example, a 86,800-square-feet premise located in Airside in Kai Tak, Kowloon was leased to MUFG bank to consolidate its office located in Central and Quarry Bay, and Deloitte also took a lease of premises at The Millennity in Kwun Tong to reduce a part of their Admiralty office space.[2] In fact, the loosening of pandemic control measures followed by the border reopening since the first half of 2023 have also brought back a lot of inspection activities amongst local tenants and mainland companies. The launch of the Inland Revenue (Amendment) (Tax Concessions for Family-owned Investment Holding Vehicles) Ordinance in 2023, which provides tax concession to family offices established in Hong Kong, will also bring a potential growth in demand for premium office spaces from wealth management and private banking businesses targeting the high net-worth individuals and families. All these present a positive impact of developing thriving office hubs in the new office-build areas and also add fuel to the revitalisation of old buildings to meet tenants' evolving needs in the long run.

Conservative Approach in Industrial Investments

On the other hand, investment in industrial premises is heavily affected by the global economic climate despite the slight increase in export after China has reopened its border this year. Due to the growth of storage demands during the pandemic, the demand for industrial premises, particularly mini-storage, cold storage, data and logistics centres, remains resilient in capital and rental values and remains stable in Q2 of 2023 given the relatively quiet market activities. However, the overall investment appetite in industrial assets and leasing activities is gloomed by the weak logistic demand, decline in trade value and relatively high interest rates, making businesses more conservative in their expansion decisions and more cost cautious. Presently, industrial leasing transactions currently centre around renewals. A standout industrial performer could be the cold chain logistics sector. For example, KaiLong Group and Reitar Logtech Group started the construction of a large-scale automated cold chain project in May of this year, involving a conversion of an old industrial building in Kwai Chung into an automated cold chain logistics centre with a total GFA of over 200,000 sq ft, making it Hong Kong's largest automated cold chain logistics centre.

Residential market currently driven by interest rate spike

Despite the large influx of mainlanders since the border reopened, the sentiment for residential purchases is greatly affected by the increase in interest rates and mortgage and financing/refinancing costs. This has discouraged transactions in both primary and secondary markets, with the lowest secondary transaction volume since January 2020 recorded in July 2023, according to Jones Lang LaSalle's research. The spike in interest rates has also led to a gradual increase in foreclosure and distressed sales in the luxury residential market. Meanwhile, the Government is continuing its "trawl for talent" measures to attract and retain non-local students, graduates, talents and young professionals in the city, which include the amendment of the legislation to provide for refund of Buyer Stamp Duty and partial refund of Ad Valorem stamp duty for eligible incoming talents who purchase residential properties after 19 October 2022 and continues to hold the same upon their becoming Hong Kong permanent residents. Amid this sluggish high interest rate environment, it will take a longer time for the non-locals to react to such favourable measure. Still, such talents and young professionals may stimulate a new housing landscape with an increasing leasing demand in co-living, youth hostel and multifamily residences. As the city's population continues to age, coupled with a scarcity of elderly homes, there is also a potential for developing and investing in more sophisticated residential facilities offering comprehensive medical care services and retirement community for the seniors.

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Despite the large influx of mainlanders since the border reopened, the sentiment for residential purchases is greatly affected by the increase in interest rates and mortgage and financing/refinancing costs.

2. https://realestateasia.com/commercial-office/news/hong-kong-overall-office-rents-rise-5-end-2023

Looking Forward

The future outlook of the Hong Kong office property market is hedged on Chinese firms driving the rebound as part and parcel of the city's structural change as it becomes increasingly integrated with mainland China.[3] Whilst all sectors are performing differently in the post-pandemic era, one thing can be certain is that the investment appetite of the assets in the short term will largely depend on the interest rate environment which, at present, poses a challenge in owning not only residential but all commercial and industrial premises as well.

Many mainland and overseas investors have also expressed concerns and raised queries regarding the certainty of lease terms under the various land grant documents from the Government, as all lands in Hong Kong (except St. John Cathedral) are leasehold interests and under the extension policy, extension of non-renewable lease term is subject to the Government's sole discretion and exercisable only around three years before expiry. At present, the earliest batch of land leases involving about 50 lots will soon expire in 2025. The recent legislative proposal introduced by the Lands Department may bring some comfort on this issue. Under the proposal, the existing process by way of offering new lease conditions to landowners for execution subject to satisfactory proof of title prior to issuance of new land lease will be replaced by a streamlined process of publishing gazette notices about three years before the expiry of the land leases for those land leases that will not be extended. In such an arrangement, all leases not published in the Gazette will be extended for 50 years without premium payment but subject to payment of annual Government rent. This legislative proposal is still under preliminary discussion stage, but this has put the investors at ease and removed the doubt as to extinguishing of the landowners' interest upon expiry of the lease term.

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> Many mainland and overseas investors had also expressed concerns and raised queries regarding the certainty of lease terms under the various land grant documents from the Government.

Struggled through and battered by the halt of the market activities during the past three years, we have confidence and believe that Hong Kong will strive to regain its competitive edge with the continued support of the policy from China on the Greater Bay Area in which Hong Kong forms a part thereof. The influx of incoming tourists, business operators, talents and professionals from mainland China and abroad definitely represents a silver lining for Hong Kong to recover and stabilise its growth in the property market gradually. Experiences from the pandemic have made the city more flexible and innovative in making adjustments to our practices and measures to cater for the dynamic change in Hong Kong's property market.

We constantly monitor the market situation in Hong Kong. Our Real Estate team in Hong Kong is led by our senior Real Estate partner, Polly Chu, who has over 25 years of experience in the Real Estate market. Her team also works closely with Withers' International Real Estate Team in Singapore, Tokyo, Europe and US offices to assist our clients with complex and cross-border transactions.

3. The Business Time, 'China firms will drive Hong Kong office marked rebound, Gaw says' (12 September 2023).

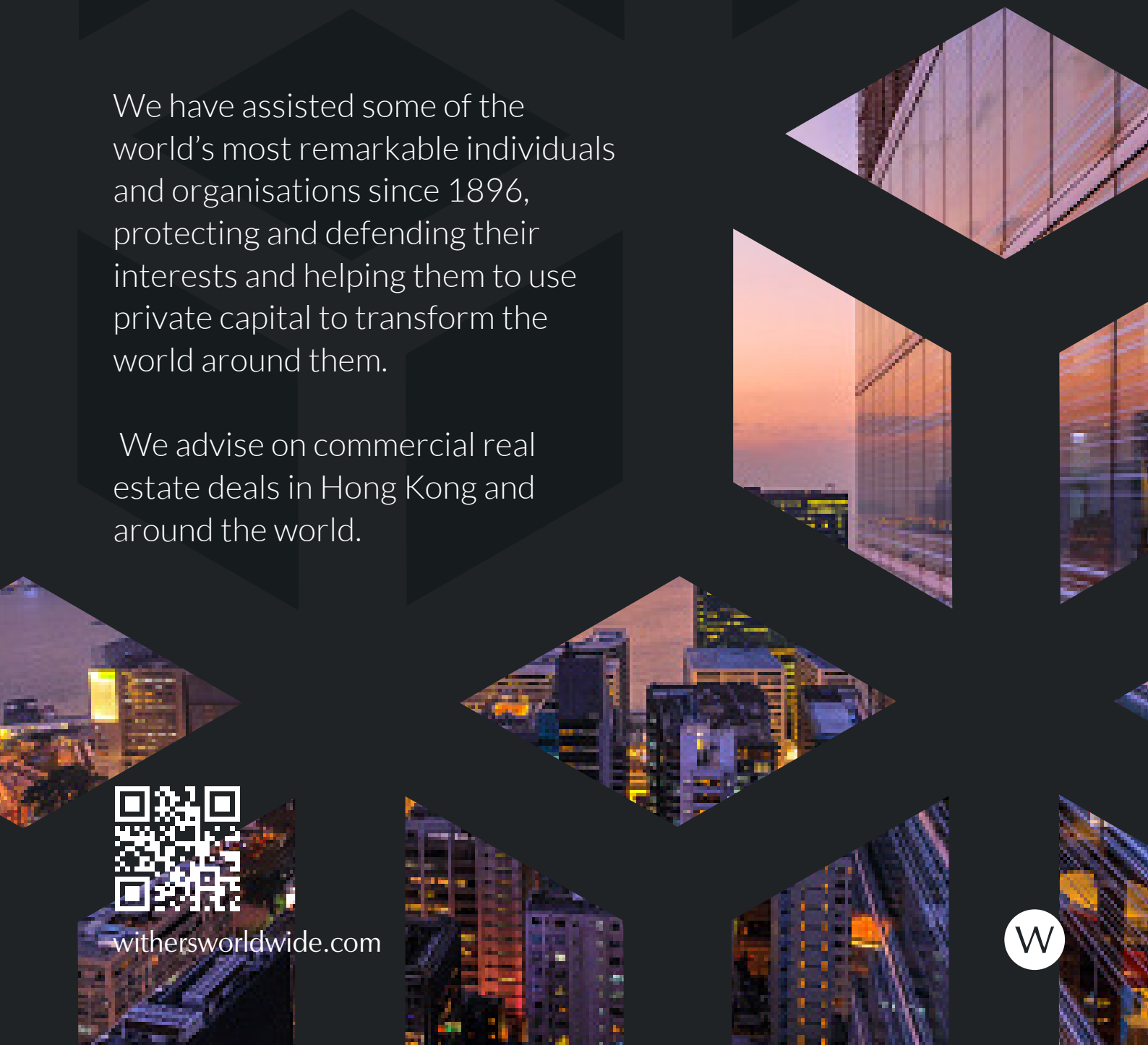
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JAPAN

Key developments & the latest trends in Japan – from a legal perspective

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BIO

Fuyuki Uchitsu is a partner who practises in the real estate, construction, structured finance and banking. He handles a wide range of real estate projects, including acquisitions, developments, large-scale redevelopments, management and sale of office buildings, residentials, hotels, retail facilities, and logistics facilities. He also has extensive experience and considerable expertise handling cross-border projects, including US real estate investment and financing as well as inbound investment by foreign investors.

Mori Hamada & Matsumoto has a real estate practice that extends from traditional acquisition and leasing transactions to complex fund structures involving a special purpose vehicle or a trust, or even investment structures for overseas properties. The team's work in this practice primarily involves private fund formation for domestic and overseas properties, J-REITs, real estate acquisition, development and disposition, and real estate financing.

MORI HAMADA & MATSUMOTO

Key developments & the latest trends in Japan – from a legal perspective

1. Current Trends in Real Property Investment into Japan

The Japanese commercial real property market has been active of late, especially attracting attention from overseas investors due to low interest rates and the depreciation of the yen. Particularly, there has been a tremendous increase in the number of hotel developments, renovation and sales transactions, from small to large scale. Also, many development projects for large-scale logistics properties and data centre facilities have been completed or planned. There continues to be a strong appetite for investment in rental residential properties and a lot of newly established residential investment funds have been formed recently. On the other hand, the Japanese office market is still holding up well compared to the global recession, but the vacancy rate has not decreased to date; there is a concern that, because of many large-scale redevelopment projects in the next few years, a large supply of high-grade office floors may drive up the vacancy rate.

2. Basic Scheme to Invest in Japanese Real Property from Overseas

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> In Japan, commercial real property is often traded in the form of a trust beneficial interest (“TBI”).

Although it is legally possible for a foreign entity to directly or indirectly own real property in Japan, not many overseas investors choose to purchase for reasons of tax efficiency. To achieve this, the following arrangements are often used.

2.1 Use of Property Trust

In Japan, commercial real property is often traded in the form of a trust beneficial interest (“TBI”) rather than an outright sale and purchase of the real property, to reduce taxes on the real property transfer. In general, when a person acquires outright ownership of real estate, (a) a registration license tax (for the registration of the ownership transfer) and (b) a real estate acquisition tax are imposed, based on the assessed value of the property listed in the fixed property tax register book. In the case of a sale and purchase of a TBI, these tax rates are significantly lower, as shown in the table below (as of September 2023):

	Land		Building	
	Real Property	TBI	Real Property	TBI
Registration License Tax	1.5%	JPY1,000 per property	2.0%	JPY1,000 per property
Real Property Acquisition Tax	1.5-3.0%	0.3%	3.0-4.0%	0.4%

When a property trust is used, the ownership of the real property is entrusted to a trustee, which holds the legal ownership of the real property for the benefit of the trust beneficiary (i.e., the TBI holder). The trustee manages the real property in accordance with the terms of the trust agreement and the instructions of the trust beneficiary.

When using a property trust, it should be noted that, in general, the trustee must be a licensed trust bank or trust company, so trust fees and other expenses will be incurred – hence, a property trust is usually used when the investment is above a certain size.

For tax consideration, the property trust usually falls under the category of “beneficiary taxable trust”, in which the beneficiary of the trust is deemed to have assets and liabilities attributable to the trust property, and the income and expenses attributable to the trust property are deemed to be the beneficiary’s income and expenses for corporate and income tax purposes (pass-through taxation).

2.2 Use of Unique Tax Oriented Investment Structure

In order to enhance the tax efficiency in respect of profits generated from a real property or TBI, tax-oriented investment schemes unique to Japan are often employed for real property investments.

There are two commonly used types of investment structures in Japan: (a) the TMK structure and (b) the GK-TK structure. By using TMK or GK-TK structure, double taxation at the level of an asset holding entity (TMK or GK) and its investor (a shareholder in the case of a TMK or a TK investor in the case of a GK-TK structure) can be avoided.

(a) TMK Structure

Overview of TMK

A TMK structure involves a specified purpose company known as *tokutei mokuteki kaisha* (TMK), which is a corporate entity specifically designed to acquire a specific asset (such as real estate assets) by issuing asset-backed securities under the Asset Liquidation Law.

A TMK may acquire real properties either in the form of actual real property or a TBI. Although a TMK can acquire an unlimited number of TBIs, it cannot acquire additional actual real property unless it is closely related to the actual real property already owned by the TMK. The business and operations of a TMK must be conducted in accordance with the asset liquidation plan ("ALP"), one of the constitutional documents of TMK, and a TMK is not permitted to engage in the operational business (e.g., hotel management business).

The TMK's equity consists of "specified shares" and "preferred shares", with no minimum capital requirement. Specified shares are similar to ordinary voting shares of a *kabushiki kaisha*, or a ordinary Japanese stock company. Investments in specified shares is typically nominal (such as JPY100,000) and are not supposed to be used for the acquisition of real properties. Preferred shares comprise most of the TMK's equity.

In general, (i) a TMK finances the acquisition of real properties (in either form) by issuing preferred shares and obtaining third-party debt in the form of "specified bonds" and "specified loans"; (b) a TMK must always have at least one director and one statutory auditor, and should appoint one accounting auditor, who must be either a certified public accountant or an auditing firm; and (c) certain fundamental matters with respect to a TMK require the approval of its shareholders (generally, only specified shareholders have voting rights at shareholders' meetings).

Tax Consideration

The best feature of a TMK is that, by fulfilling certain requirements, it is eligible to deduct profit distributions to its preferred shareholders from its taxable income (pay-through treatment). In practice, the key requirements for a TMK to achieve pay-through treatment are, among other things, the following

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There are two commonly used types of investment structures in Japan: (a) the TMK structure and (b) the GK-TK structure.

(i) The TMK must issue specified bonds to a tax qualified institutional investor ("**Tax QII**"), as defined in the Act on Special Measures Concerning Taxation;

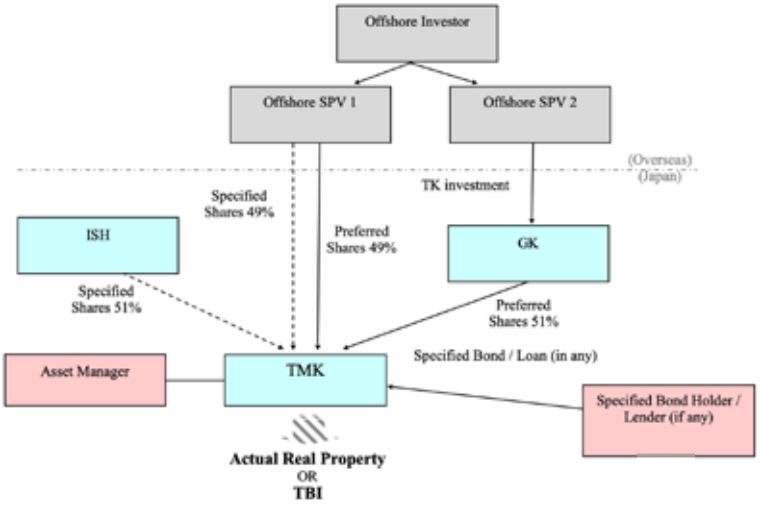
(ii) If the TMK takes out a specified loan, the lender should be a Tax QII;

(iii) More than 50% of the preferred shares must be offered in Japan;

(iv) More than 50% of the specified shares must be offered in Japan, unless it is stated in the ALP that the specified shareholders have waived their rights to profit distributions and distributions of residual assets; and

(v) The TMK distributes dividends in an amount exceeding 90% of its distributable profit per fiscal year, as calculated under the tax code.

Sample TMK structure



> By using TMK or GK-TK structure, double taxation at the level of an asset holding entity can be avoided.

(b) GK-TK Structure

Overview of GK-TK

The GK-TK structure is an investment scheme established by a *godo kaisha* (GK), which is a type of Japanese limited liability company, entering into a certain type of partnership agreement, known as *tokumei kumiai* (TK) agreement, with an investor. A TK is just a contractual arrangement formed under a TK agreement between the GK as operator and the TK investor, as a way of creating equity-like investments.
If there are several TK investors, each TK investor enters into its own TK agreement with the GK (TK operator), but usually the terms of the TK agreements are the same except for the investment amount.

In accordance with the TK agreement, a TK investor contributes funds to the GK (TK operator) and the GK (TK operator) conducts the TK business, which is defined in the TK agreement, using the funds so contributed. Thereafter, the GK (TK operator) distributes profits from the TK business to the TK investor.

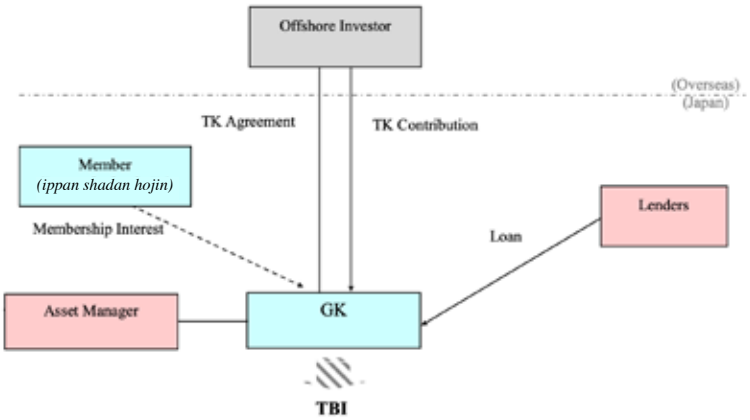
In the GK-TK structure, a GK is incorporated as a special purpose vehicle without human resources, with one corporate entity being the sole managing member representing the GK, and such managing member appoints an individual (operating officer) to act as its representative and perform the duties of a managing member. As there is no specific minimum capital requirement, the paid-in capital of a GK is usually nominal (such as JPY100,000). Due to regulatory and tax reasons, the real property to be acquired under a GK-TK structure is usually in a form of TBI as opposed to actual real property, but a GK-TK can acquire multiple TBIs (including additional acquisitions).

Tax Considerations

In principle, the profits and losses related to the TK business belong to the GK, and corporate tax will be imposed on GK. However, if the TK agreement is legally valid and recognised as a TK for tax purposes, the amount of profit to be distributed to the TK investor or the amount of loss to be borne by the TK investor under the TK agreement may be included in the amount of loss or profit in the calculation of the taxable income of GK for the relevant fiscal year. Therefore, the GK-TK structure enables to avoid the double taxation.

One of the most important points to note is that, because the TK is not a joint venture in a sense that TK operator manages the TK business but the TK investor does not, any form of participation by the TK investor in the TK business (e.g., by way of a right to approve or disapprove material decisions regarding the TK business or otherwise) would invite a risk that jeopardises the characterisation of the nature of the TK from a tax perspective. If the TK agreement involves an non-Japanese TK investor, the tax re-characterisation risk would have a significant implication because the GK (TK operator) would be recognised as a permanent establishment of the TK investor and therefore the profit at the GK level would be subject to regular Japanese income tax. Because of this tax sensitivity, overseas investors tend to avoid the GK-TK structure.

Sample GK-TK structure



3. Asset Manager

As a special purpose vehicle, a TMK or GK must retain an external advisor to ensure the proper management of its business, including the exercise of its rights (e.g., giving instructions to the trustee under the trust agreement for matters relating to the management of the real property) and performance of its obligations under the transaction documents (e.g., preparing and dispatching necessary notices or reports to the lenders under the finance documents) to which it is a party.

The asset manager of a TMK or GK must obtain a certain license, depending on the structure and underlying asset.

Asset Manager for a TMK structure

The type of license required to be obtained by the asset manager of the TMK depends on whether the TMK will acquire actual real property or a TBI.

- If the TMK will acquire actual real property, the TMK needs to sub-contract the management and disposal of the real properties to an asset manager who is licensed to engage in a real estate transaction business (*takuchi tatemono torihiki gyo*) under the Real Estate Transaction Business Law; and

- If the TMK will acquire a TBI, the TMK needs to sub-contract its day-to-day operations, including issuing instructions to the trustee, to an asset manager who is registered to engage in the investment advisory business (*toshi jogen gyomu*, "**Investment Advisory Business**") or investment management business (*toshi un'yo gyo*, "**Investment Management Business**") under the Financial Instruments and Exchange Law (the "**FIEL**"), since TBIs fall under the category of securities under the FIEL.

Asset Manager for GK-TK structure

As mentioned, due to regulatory and tax reasons, the real property acquired under a GK-TK structure is usually in the form of a TBI as opposed to actual real property.

> "As a special purpose vehicle, a TMK or GK must retain an external advisor to ensure the proper management of its business.

The type of license to be obtained by the asset manager to a GK that will acquire a TBI primarily depends on whether or not there is at least one "qualified institutional investor", as defined in the FIEL (the "**QII**").

- If there is at least one QII, the GK may rely on the QII-targeted Fund Business exemption, which is meant to reduce the regulatory burden normally imposed by the FIEL. In this case, the asset manager must be registered to engage in an Investment Advisory Business or an Investment Management Business; and

- If there is no QII, the GK needs to delegate its entire investment management authority for the benefit of the TK investors to an asset manager who is registered to engage in an Investment Management Business.

4. Requirement of Bankruptcy Remoteness by Lenders

When debt financing is provided to a special purpose vehicle (TMK or GK) purely based on the credibility of the underlying asset, without recourse to the other parties involved in the investment structure (e.g., by way of parent guarantee or otherwise), financiers typically require certain measures so as to minimise the insolvency risk of the special purpose vehicle or to achieve what is often referred to as "bankruptcy remoteness" in Japan. Such measures usually include using an *ippan shadan houjin* (ISH), whose directors are independent from the sponsors (in many cases, two accountants dispatched from a tax accounting firm), as the parent company of the special purpose vehicle. The purpose of having an ISH is to use it as an independent entity holding equity interests in a TMK or GK to achieve bankruptcy remoteness; therefore, the ISH is not expected to have any significant participation in the distribution of profits from the TMK or GK.

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Structuring an investment in Japanese real property can be complex, bespoke, and require careful consideration from both a legal and tax perspective.

In practice, for the purpose of acquiring working capital for the ISH, the asset manager, investor or other party with an interest in the transaction would contribute capital to the ISH in the form of an endowment (*kikin*), but the contributor has no voting rights or any other right to control the ISH.

5. Conclusion

Structuring an investment in Japanese real property can be complex, bespoke, and require careful consideration from both a legal and tax perspective. It is important for all parties involved to understand what is fundamental to Japanese practice and what is specific to the present case. From this perspective, the roles of the local legal advisor providing structuring advice from a regulatory perspective and the international tax advisor providing tax advice, including tax treaty analysis, are critical. Ultimately, successful structuring can help mitigate financial losses and increase the effectiveness of the investment.

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BIO

Veronica Aroutiunian, partner, is a member of the Investment Management practice group in the Luxembourg office of Loyens & Loeff.

She focuses on structuring and formation of alternative investment funds, particularly within the real assets sector. She is also a member of the Real Estate Industry focus team and the Regional Team France. Veronica specialises in fund structuring, with a special focus on real estate, infrastructure, private equity and private debt funds, as well as global transition funds. She advises clients on the regulatory and corporate aspects of structuring, establishing, operating and marketing Luxembourg regulated investment vehicles (Part II UCIs, SIFs and SICARs) and unregulated investment vehicles (including RAIFs and Luxembourg partnerships).

Veronica is active in the Association of the Luxembourg Fund Industry (ALFI) and the Luxembourg Private Equity & Venture Capital Association (LPEA), participating in working groups and presenting at conferences.

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Ana specialises in private equity matters and advises a range of sponsors on a wide range of corporate and transactional matters, including day-to-day corporate and governance aspects, co-investments and joint ventures, acquisition funding, and complex restructurings that often include cross-border elements. She also has additional significant experience in finance and in debt and equity capital markets projects.

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Real Estate Investment Funds in Luxembourg

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Introduction

Looking to raise capital in Europe and around the world and invest in real estate? Choose a Luxembourg investment fund.

Luxembourg's adaptable legal and tax environment has positioned it as a European hub for diverse investment vehicles, particularly real estate funds, catering to global investors' needs. Its robust security interest system bolsters creditor protection, establishing it as a secure global financing domicile. Asset management through pooled funds often involves special purpose vehicles for ringfencing and tax efficiency. With 80+ double tax treaties and evolving corporate laws, Luxembourg provides streamlined options for acquisitions, joint ventures, and employee participation schemes.

Structuring of Luxembourg REIFs

Within a sophisticated Luxembourg toolbox, the choice of the real estate investment fund (**REIF**) vehicle typically depends on the target market in terms of capital raising and investment opportunities. Luxembourg REIFs can take the form of regulated entities, under direct supervision by the CSSF (Luxembourg's regulator), or unregulated entities and can either be managed by a European manager, authorized to market the fund through the European passport regime, or by a registered or non-European manager utilising national private placement regimes to raise funds. These REIF products can be categorised into two groups: (i) retail REIFs with strict investment limitations and (ii) REIFs tailored for professional and high-net-worth investors offering varying degrees of investment flexibility. For managers pursuing diverse investment strategies, such as targeting specific sectors or regions, Luxembourg REIFs often facilitate the structuring of multi-compartment (or umbrella) vehicles. In an umbrella, each compartment is associated with a distinct investment portfolio segregated from other compartments' portfolios via legal ring-fencing. This ensures that the assets of each compartment solely serve the rights of investors and creditors related to that specific compartment.

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> Luxembourg's adaptable legal and tax environment has positioned it as a European hub for diverse investment vehicles, particularly real estate funds, catering to global investors' needs.

Managers aiming at retail investors must structure their Luxembourg REIF as an Undertaking for Collective Investments, governed by Part II of the Law of 17 December 2010 (**Part II UCI**). Part II UCI requires prior approval and ongoing oversight by the CSSF, and the appointment of an alternative investment fund manager (**AIFM**) authorised under the Directive 2011/61/EU on Alternative Investment Fund Managers (**AIFMD**). It stands as Luxembourg's sole alternative investment fund accessible to retail investors. However, the distribution of Part II UCIs to retail investors within the European Economic Area (**EEA**) is contingent upon local regulations in each respective jurisdiction, as there is no European retail passport under the AIFMD.

Part II UCI may invest in diverse real estate assets and strategies, as long as it doesn't allocate over 20% of net assets to a single property (this limit becomes effective upon property acquisition, and after a maximum four-year ramp-up period). Additionally, the aggregate borrowing of Part II UCI cannot exceed an average of 50% of the valuation of its properties.

To facilitate distribution to retail investors in the EEA, managers can incorporate a European Long Term Investment Fund (ELTIF) 'wrapper' into their Part II UCI. A Part II UCI, or a compartment thereof, could benefit of the ELTIF label and distribution passport available under the amended Regulation 2015/760, provided the AIFM is EU-authorsied, and over 55% of capital is invested in eligible real assets. ELTIFs entail stricter investment rules than Part II UCIs without ELTIF wrapper, including limitations on techniques like short selling, repos, securities lending and use of financial derivatives. ELTIFs can only be set up as master-feeder structures, provided both the feeder and the master are ELTIFs, and fund-of-fund ELTIFs can only target European AIFs.

ELTIF lures retail investors in EEA with distribution passport whereas Part II UCI offers structuring flexibilities (open/closed-ended, limited/unlimited term). There is growing interest in hybrid models with ELTIF compartments under umbrella Part II UCIs.

Managers targeting professional and semi-professional investors can opt for various Luxembourg REIF regimes:

(i) Specialised Investment Fund (**SIF**) under the Law of 13 February 2007
(ii) Investment Company in Risk Capital (**SICAR**) under the Law of 15 June 2004
(iii) Reserved Alternative Investment Fund (**RAIF**) under the Law of 23 July 2016

These REIFs are reserved to 'well-informed investors', i.e., institutional investors, professional investors and investors who have confirmed in writing that they adhere to the well-informed investor status, and who either invest a minimum of EUR 100,000 or have been assessed by an eligible financial institution.

SIFs and SIF-like RAIFs can invest in various real estate assets and pursue any real estate strategy, subject to a 30% concentration rule. SICARs and SICAR-like RAIFs are not subject to diversification requirements but may only invest indirectly via entities in 'risk capital' qualifying assets with an intention to develop a project (no core/core plus strategies).

SIFs and SICARs require prior CSSF approval, while RAIFs are formed and operate without CSSF's involvement. However, whereas SIFs and SICARs may be managed by registered or non-European AIFMs, a RAIF must appoint an EU-authorised AIFM.

It is also possible to structure a Luxembourg REIF outside the ambit of product laws, taking on any Luxembourg corporate form, contingent on AIFMD compliance. The most favored entity is the Luxembourg special limited partnership, functioning as an alternative investment fund, managed by an EU-authorised AIFM, registered European AIFM, or non-European AIFM, depending on assets under management, and the requirement for a European marketing passport to raise capital. Such REIFs are exempt from CSSF supervision and investment constraints.

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To facilitate distribution to retail investors in the EEA, managers can incorporate a European Long Term Investment Fund (ELTIF) 'wrapper' into their Part II UCI.

Except SICARs, Luxembourg REIFs can be SICAVs (variable capital investment companies) or FCPs (co-ownership managed by Luxembourg management company). A SICAV is a Luxembourg company (of any type) whose capital constantly fluctuates, without any further formalities, with changes in subscriptions, redemptions and valuation of assets, so that it is at all times equal to the net asset value of the company (i.e., the value of its assets minus liabilities). An FCP is not a legal entity. Investors subscribe for units in the FCP which represent a portion of the net assets, and they are only liable up to the amount they have contributed. Voting rights are typically absent for FCP investors, and decisions regarding investments and operations rest with the management company, unless otherwise specified in fund documentation.

The administration of a Luxembourg REIF requires the appointment of a Luxembourg depositary, responsible for verifying asset ownership. Eligible depositaries encompass Luxembourg credit institutions and professional depositaries for assets other than financial instruments.

The annual report of a Luxembourg REIF must be audited by a Luxembourg authorised independent auditor (*réviseur d'entreprises agréé*). Luxembourg GAAP and IFRS are the applicable accounting standards, except for unregulated alternative investment funds in the form of special limited partnerships.

The registered office and central administration of a Luxembourg REIF must reside in Luxembourg. Hence, in instances where adequate internal resources are lacking, the appointment of a domiciliary and fund administrator, overseen by the CSSF, is necessary for the administration of a Luxembourg REIF.

External financing solutions for Luxembourg REIFs

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> Luxembourg REIFs' managers may also have access to net asset value (NAV) or asset-backed financing arrangements.

External financing solutions are available to managers of Luxembourg REIFs at all levels of the capital structure.

The subscription line financing is a useful liquidity tool, frequently used by REIF managers. Also called, capital call facility, this financing is provided by lenders directly to the fund, where the recourse of the lenders is to the uncalled investor commitments of the fund. These arrangements are usually short-term facilities used to bridge the capital contributions of the investors and are subject to a borrowing base, determined by the value of the investors' available commitments satisfying certain eligibility criteria. Typically, the security package is comprised of a pledge by the fund of its rights under the uncalled investors' commitments, and the claims against the investors in relation thereto, as well as of a pledge over the bank account dedicated to investors' contributions.

Luxembourg REIFs' managers may also have access to net asset value (NAV) or asset-backed financing arrangements. These borrowing arrangements are facilities made available to the fund (or an SPV held by the fund) with recourse to the fund's portfolio of assets. Given that the borrowing base is calculated on the net asset value of the assets of the fund (being the primary source of repayment), this financing product is usually made available at an advanced stage of the investment period, once the REIF has acquired sufficient investments. Lenders will analyse the underlying investments, as well as cash flows and other distributions that the REIF will receive from those investments. The security package may be composed of pledge over shares, receivables, loans and/or bank accounts into which investments proceeds are to be paid with the aim to allow the lender to control the underlying assets or distributions paid on such assets. NAV facilities may be used for working capital, follow-on investments, distributions or provide liquidity to distressed portfolio companies.

Hybrid products combining subscription financing and NAV financing features may also be used by Luxembourg REIFs.

At asset level, a secured loan made by third party lenders remains the key financing tool for managers of REIFs, with two main types of product: the investment loan (financing of an existing property let to existing tenants) and the development loan (financing of a purchase and development of a property). The borrowing entity is usually the company holding the real estate asset and the typical security package for these financings are a mortgage over the financed property, as well as security interests over any other of the borrower's assets, such as bank accounts into which any accounts or proceeds are paid. It is also common for the shareholder of the borrower to pledge all its interests (shares and claims) in the borrower. In addition, in a development loan, lenders will also seek to take security over the rights of the developer in respect of any development documents during the construction phase. Lenders may also require that the REIF provides credit support for the obligations of the borrowing entities (notably equity commitment letters or guarantees).

Where the amount of the loan to be advanced (combined with the REIF's equity contribution) is not sufficient to finance the project, mezzanine financing solutions, which will be structurally or contractually subordinated to the senior lenders' debt, can be implemented to bridge the gap.

A view from underneath the REIF – SPVs, co-investments, and joint ventures

In addition to being the jurisdiction of choice for the establishment of the fund, Luxembourg is also a suitable destination for the asset acquisition structure of the REIF due to its flexible but predictable tax, legal, regulatory and general commercial environment. In addition, Luxembourg collateral law offers a unique blend of flexibility and certainty for the creation, perfection and enforcement of security interests (in particular over the shares of a Luxembourg company), making Luxembourg a jurisdiction of choice for structuring leveraged finance transactions in particular.

An important point of attention from a Luxembourg law perspective is the fact that Luxembourg follows the "real seat" theory, which means that - unlike other jurisdictions such as the Netherlands, Ireland and the United Kingdom, which follow the "incorporation" theory - a Luxembourg entity is considered to be a Luxembourg entity and subject to Luxembourg law only, to the extent that it has its "real seat" in Luxembourg. Many different terms are used in connection with this concept - 'central administration', 'principal place of business', 'effective management', 'domicile' - with Luxembourg company law referring to both 'central administration' and 'domicile'. Under Luxembourg company law, there is a rebuttable presumption as a matter of law that the central administration of a company is located at the address of its registered office.

The presence or substance of the company in Luxembourg may also be a condition for access to tax benefits (in particular under tax treaties). In the case of a tax transparent fund, such access to tax treaty benefits may be particularly important for the Luxembourg company (typically a SARL and often referred to as a Master HoldCo) that sits immediately below the REIF, and is used by the REIF as an investment platform.

A chain of Luxembourg companies is often involved in the acquisition structure set up below the Master HoldCo in order to meet the various liability shield, tax or financing structuring requirements. For investments of a REIF, the Luxembourg *société à responsabilité limitée* (SARL) remains the most popular choice for financing entities and acquisition vehicles further down the chain.

A leveraged acquisition structure will typically include at least one other mid-tier holding SARL above the SPV used to invest in the property, with additional holding SARLs potentially added to the chain to facilitate co-investments or joint ventures.

Under Luxembourg company law, there is a rebuttable presumption as a matter of law that the central administration of a company is located at the address of its registered office.

While typical joint ventures between the REIF (via a chain of subsidiaries) and the asset manager are designed to marry the interests of the capital provider with the expertise and asset servicing knowledge of the asset manager, while ensuring that the manager has sufficient "skin in the game", co-investments are becoming increasingly popular with investors seeking to gain more direct exposure to interesting and attractive assets, while benefiting from a better deal on fees, or a better grip on governance and exit strategy.

A wide range of financing structures are available under Luxembourg law. Typically, transactions are funded by investors through a variety of different financing instruments, split between equity (ordinary shares, preference shares, warrants) and debt (loans, bonds, preference shares), with most transactions involving a combination of two or more such instruments. Bank financing is typically secured by pledge agreements (most commonly share pledges, receivables pledges and account pledges).

In terms of exit, the most common full exit mechanism is the sale of the SPV holding the assets, followed by the liquidation of the holding stack. In a partial exit scenario, cash is returned to the REIF through share redemptions, dividend distributions or debt repayments, or a combination of these.

Conclusion

The Luxembourg real estate fund landscape is characterised by several notable trends. One prominent trend is the sustained growth of larger funds, boasting assets under management exceeding one billion EUR. Despite current concerns about rising interest rates, the appetite for alternative investments and private assets is steadily growing. Investors are looking for innovative products aligning with long-term objectives and diversification. Alternatives, including real estate, are also becoming integral to pension solutions. With interest rates stabilising as central bank policies become more predictable, a renewed interest in real estate investments is anticipated, with a particular focus on sustainability, underlining the sector's resilience and potential upswing. With its global reputation for real estate investment funds, Luxembourg is well equipped to provide solutions for all stages and needs of the real estate fund and investment lifecycle, and is expected to remain at the forefront of developments.

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POLAND
Growing impact of ESG factors in commercial real estate financing

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He assists both investors, including private equity funds, public and private companies, as well as Polish and foreign financial institutions. He advises clients on all stages of transactions and works on deal structuring, term sheets, loan agreements, including contracts based on the LMA standard, intercreditor agreements and security documents.

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Growing Impact of ESG Factors in Commercial Real Estate Financing

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The attribution of a key role to financial institutions in connection with the achievement of the UN's Sustainable Development Goals[1], i.e. the action plan to transform the world so that the needs of today's generation can be met in a sustainable way while respecting the environment and taking into account the needs of future generations, is now one of the more frequently repeated theses. Considering, amongst others, the goal relating to climate actions, the role played by banks financing commercial real estate sector, which is considered producing substantial part of global carbon emissions and global energy demand, seems particularly important.

The European Union's climate change legislation sets out the long-term direction of EU climate policy. The EU's goal is to achieve zero net greenhouse gas emissions by 2050 (climate neutrality). Transformation risks affect mostly sectors with higher levels of greenhouse gas emissions (including commercial real estate). Banks with exposures to borrowers that are unable to successfully adapt to carbon-neutral economies and other requirements may suffer greater credit losses.

The concept of ESG, i.e., all issues related to environmental, social, and corporate governance, is becoming increasingly important for many companies and institutions, but also for the economy as a whole (with a strong emphasis on "E" when it comes to the commercial real estate sector). This has to do, among other things, with increasing regulatory pressure in the EU, market pressure, ownership requirements (with a growing segment of investors opting for "green" investments) and the ability to raise finance, especially in the long term. Although the ESG principles apply to every sector, the impact will vary.

> "The EU's goal is to achieve zero net greenhouse gas emissions by 2050 (climate neutrality).

Redirecting capital flows towards more sustainable operations and investments has a real impact on the activities of financial institutions. While they do not have a significant share in the CO2 emissions, they can influence the development of specific industries with their financing. Banks, among others, are the entities that — as intended by the European Commission and politicians and given the scar city of public funds in the EU — will play an important role in redirecting funding from carbon-intensive sectors towards low-carbon sectors or the energy transition. This will be achieved through changes in the investment and lending policies of financial institutions, among other things, affecting lending to the real economy.

Non-financial reporting, the scope of which has expanded over recent years mostly due to the entry into force of the Corporate Sustainability Reporting Directive (CSRD)[2], requires banks to analyse the impact of their activities on the achievement of sustainability objectives. The specific nature of the banking sector's activities means that measures of this impact are linked to the financing provided to the banks' customers. Banks interact with their customers to implement and fulfil their obligations imposed by EU legislators and have been assigned a special role in the EU economy as a catalyst for green change by gradually redirecting the flow of finance to green companies and green projects. The most important and direct impact will be achieved through the modification of the criteria for financing provided by banks.

1. www.un.org/sustainabledevelopment/sustainable-development-goals/
2. Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, regardin corporate sustainability reporting.

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Energy use in buildings is associated with a noticeable contribution to greenhouse gas emissions, making upgrading the energy efficiency of existing buildings or stringent requirements for new buildings a key aspect of climate transformation policy in the EU. In this regard, differences in the energy efficiency of buildings may be associated with different levels of exposure to transition risk, potentially materialising in the market value of the building through changes in the market demand towards a preference for energy-efficient buildings or policy changes regarding energy-related building regulations. It seems that zero-emission buildings will gain in value in the future, while others are likely to depreciate or, in the longer run, even become unsaleable.

Banks active in the Polish commercial real estate market have almost universally incorporated components of sustainable finance into their range of products and services and are already taking many actions in response to regulatory requirements. The banking sector in Poland shows a strong commitment and willingness to support sustainable development goals and this approach is having an increasing impact on financing of commercial real estate sector.

We have observed a growing number of loans provided by banks on the commercial real estate market in Poland classified as "green loans" or quasi green loan type. The frameworks for such loans vary across the lenders' internal standards and requirements. However, based on the Loan Market Association's Green Loan Principles (GLP) and Guidance on Green Loan Principle, to qualify as a green loan, the loan must comply with the following four components of the GLP: 1) use of proceeds, 2) process for project evaluation and selection, 3) management of proceeds and 4) reporting. This also includes applying the loan's proceeds to an eligible green project including a green building that meets regional, national or internationally recognised standards or certifications. This type of financing can be summarised as loans that must contribute to sustainable development and can be provided to projects and investments in buildings with specific green credentials that satisfy bank's requirements subject to the LMA-based framework. From the financial point of view, such a green loan offers better terms than a corresponding loan that is not green and for this reason, but also because of the growing maturity and awareness of investors, such loans are becoming more and more popular.

Apart from green loans, other ESG related factors started influencing the approach of banks to financing commercial real estate, e.g., banks have started considering certification of a building with BREEAM certificate with a rating category of either "outstanding" or "excellent" as an absolute standard necessary to implement financing rather than a nice thing to have by the property owner.

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It seems that zero-emission buildings will gain in value in the future, while others are likely to depreciate or, in the longer run, even become unsaleable.

Regulatory pressures are driving change in the EU financial sector, and financial institutions are subject to an increasing number of requirements related to environmental financial risk management and sustainability-linked disclosures. The reporting obligations are passed on to the borrowers considering the need of the lenders to collect significant amounts of ESG data necessary to review the ESG performance of the financed portfolio, hence lenders constantly seek improvements within information undertakings in the loan agreements.

Another practical implication of the ESG-driven approach of the banks financing commercial real estate assets that can be observed in financing documentation concerns undertakings relating to the reduction of energy demands or obligations to implement and comply with ESG strategy.

It has become a market standard that every facility agreement, regardless of whether it provides for green or non-green financing, relating to commercial real estate, contains environmental provisions. We expect to see ESG-related elements to further develop within property due diligence examination requirements of the banks and also at the level of LMA-based financing documentation. In addition, investors have noticed strong reputational advantages relating to sustainable financings.

Summarising, green finance is no longer a new phenomenon, but rather a permanent part of the Polish commercial real estate lending market. We expect further developments in this area and increased numbers of financing transactions based on green loans.

Private Rented Sector with potential to growth

Rampant inflation, rising interest rates and the introduction of the recommendations by the Polish Financial Supervision Authority, which tightened credit score calculations for mortgage-backed residential loans, were the factors that negatively impacted Polish residents' ability to obtain residential loans. In addition, the outbreak of war in Ukraine and the ensuing influx of refugees, has extended plans to address the housing shortage (currently estimated at around 2 to even 2.5 million units, depending on the source), progressive demographic and social changes and high prices of new apartments – all of these factors have constituted grounds in recent years for the growth of Private Rented Sector (PRS) in Poland. Also, Polish people live in overcrowded flats, as, according to Eurostat data, Poland's overcrowding rate is 19.4 pp above the EU average. The average number of rooms per person in Poland is 1.2 (0.4 less than the EU average).

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> Green finance is no longer a new phenomenon, but rather a permanent part of the Polish commercial real estate lending market.

PRS in Poland recorded a surge in growth last year. This has resulted in more than 10,300 apartments being available for rent from institutional investors by the end of 2022 according to a report by Knight Frank and Dentons. Market data clearly suggests that PRS apartments are still in demand. It is confirmed by extremely low vacancy rates in the sector estimated at ca. 3%. In many projects, the majority of apartments are rented before the project is completed.

Until recently, the rental housing market in Poland has been dominated by private investors. The sector was not of interest to institutional investors for a long time. Institutional rental has started to gain popularity and funds specialising in this sector are now thriving in the market. Many entities already investing in the commercial real estate market are beginning to consider PRS as a key complementary strategy for their investment portfolios. Many owners of old office and retail projects are considering demolishing them and replacing them with PRS projects.

From the lending point of view, we observe an increasing number of financial institutions eager to finance PRS projects at both the construction and the investment stage. Noteworthy is the financing of PRS projects in Poland by the European Bank for Reconstruction and Development (EBRD), which closed a number of transactions last year under the EBRD's Resilience and Livelihoods Framework program which aims to support Ukraine and countries affected by the Russian invasion of Ukraine.

Tenants in PRS projects pay rent in Polish zlotys. At the same time, the cost of lending in zlotys remains relatively high, as interest rates remain high. We have observed a noticeable increase in investors' willingness to secure euro loans with a sponsor's guarantee which seems to remain the only option for the banks to accept a currency mismatch.

The projected pipeline of projects is around 55,000 flats in the coming five to seven years. The PRS sector currently accounts for only ca. 1% of all apartments available for rent in Poland. Even if all planned projects are built, the institutional rental market will remain marginal. The above data confirms there is a lot of space for further PRS growth, especially since the above-mentioned reasons for the development of the PRS sector in Poland are likely to continue in the coming years. The market is awaiting major built-to-sell developers to decide to deliver more PRS projects instead of apartments for sale which should fuel further growth in the PRS sector.

Growth of demand for private debt lending

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Private debt lending (sometimes called 'private credit' or 'direct lending') has increased in popularity as an alternative to bank financing and DCM (debt capital market). Characteristic of this type of financing is that it is provided by non-licensed lenders, very rarely within syndicated structures and the loan amounts tend to be medium sized. Financing transactions involving private debt providers are, compared to bank financings, usually more time efficient (including the decisions making process) and the terms of such transactions are more tailor-made and generally more flexible. Another advantage would be fewer administrative and reporting obligations on the borrowers' side.

Banks active in the Polish real estate market have become more selective about financing certain classes of assets, the retail sector being a good example of that. In addition, the Polish government mandated mortgage holidays, which cost the banks billions and led to a reduction in their activity. These were the factors that created space for the activity of private debt lenders. However, we prefer not to classify private debt as direct competition to the services provided by banks, but rather as a means to bridge the void left by the decline in loan-to-value (LTV) ratios offered by banks.

All of the above advantages of private debt financing come at a price as borrowers have to pay accordingly. The high tolerance for risk demonstrated by private lenders is combined with an appetite for high returns. Interest rates on private debt loans are relatively higher than pricing offered by the banks.

As tax gross-up clauses are standard in financing transactions involving private debt providers, before entering into cross-border financing transactions with private debt lenders seated abroad an investor should primarily consider the tax implications, including whether any withholding tax would apply, the so-called pay & refund mechanism and what procedural formalities would be necessary for the borrower to obtain authorisation to make interest payments without or with the lowest tax deductions the given double taxation treaty or Polish law permits.
On the lending side, private debt lenders should note that, under Polish law, the contractual, capital interest on hand can be freely set by the parties to the loan agreement, but it cannot exceed the maximum interest, i.e. twice the statutory interest on an annual basis pursuant to the provisions of the Polish Civil Code. If the amount of interest under the loan agreement exceeds the maximum interest, the maximum interest is due. Contractual provisions may not exclude or limit the above provisions on maximum interest, also in the event of a choice of foreign law. If the parties choose foreign law in the agreement, the above statutory provisions will apply to maximum interest anyway. The provisions of Polish Civil Code on maximum interest would not apply to bonds' coupons nor foreign law financing at holdco level seated abroad, however, in the latter case, any debt pushdown mechanism should be carefully analysed.
Private lending is still a relatively small market with a lot of room for growth. Given the increased activity of private lenders, we can expect to see more and more financing transactions involving private debt.

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On the lending side, private debt lenders should note that under Polish law the contractual, capital interest on hand might be freely set by the parties to the loan agreement.

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UAE

Real Estate Investments and Project Financing: Latest Trends and Developments

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A solicitor of the Senior Courts of England and Wales with 13 years of cross-border litigation and arbitration, her authority in the realm has been solidified by a track record of over 300 litigations, 120 arbitration cases across premier institutions like ICC and LCIA and orchestrating over 100 settlements.

Renowned as a master strategist In the domain of private capital, her name resonates with precision-guided advice, whether it's sculpting bespoke strategies for private equity powerhouses or helming high-stakes corporate restructurings. Distinguished for her global reach, intra-disciplinary expertise, multilingual skills, and ability to represent clients in multiple civil and common law legal jurisdictions.

The accolades agree: listed under 30 under 30 to watch shortly after beginning her legal career, she has since been honoured with titles like "Young Lawyer of the Year" by DIFC Academy, a "Rising Star," by Corporate Counsel Awards, and "Businesswoman of the Year" and "Most Influential Female Lawyer".

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Owais' mission is to support and drive innovation in the a) nature of legal services we offer, b) manner of offering and packaging the service; and c) mechanism of delivery.

Owais oversees the integration of these new solutions into every aspect of the firm's operations, fostering a culture of innovation that allows us to improve our services, reduce costs, and make our processes more efficient and effective.

In the tech industry, Owais is widely recognized as a leading innovator and disruptor. He has founded three successful startups and has over 18+ years of experience in the financial industry, specifically in the areas of banking, fintech, product innovation, digital transformation, and data science. He has worked for companies such as Miletap, Hubpay, VACUK, Hendsa Partners and Lutebox. His vast knowledge and experience in these fields make him a valuable asset to the firm and its clients.

fareya araoui

Real Estate Investments and Project Financing: Latest Trends and Developments

The UAE's real estate sector has always played a game of love and betrayal with the country, being both generous and loyal to its real estate. However, in the year 2023, which the UAE has declared as "the Year of Sustainability" under the banner of "Today for Tomorrow," it seems that the sun has set on any schisms between the two, and the time of their final union is at hand.

Like any good story, several characters have played their roles. There are two major trends in the UAE's real estate market sector, both having a profound impact on the outlook, social, and economic priorities – from individuals to the country at large:

1. The unprecedented, perhaps too good to be true, soaring real estate market in 2023.
2. The elevated responsibility to combat the soaring carbon footprint of this surging real estate sector.



The Trends: Record-breaking Rise

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It is estimated that Abu Dhabi recorded 10,557 real estate transactions worth Dh46.33 billion in the first half of 2023 due to an upward trend in buyer demand.

According to the Abu Dhabi media office, citing data from the Department of Municipalities and Transport, the value of the deals more than doubled during the six-month period, while the volume of transactions grew by 41% annually.

Residential property sales in Dubai also experienced a significant surge in the first half of 2023, generating approximately $28 billion (AED 93.18 billion) in revenue. Notably, the number of units sold during this period experienced a remarkable spike of 35.25%, totalling 46,835 units, representing a 46.71% increase over the previous year. Sales values in commercial real estate were also up 30%, indicating robust growth.

Another study by CBRE showed that average residential prices in Dubai grew by 15.9% in the year through May 2023, with average apartment prices increasing by 15.9% and average villa prices by 16.0% over the same period.

Abu Dhabi's wealth fund ADQ and International Holding Co. Are combining their shareholdings in Modon Properties and ADQ's stake in Abu Dhabi National Exhibitions Co. Into a single real estate firm called "Q Holding," creating a $12 billion property giant with a portfolio of real estate developments, venues, land plots, and hospitality assets.

Trends Behind the Boom: Influx of Foreign Funds

A significant influx of Chinese investors has been coming to the UAE in recent years, driving the UAE's real estate market forward.

In early 2023, Chinese travel restrictions were lifted, enabling Chinese investors to access Dubai's property market. This came after China reopened its borders following the COVID-19 pandemic, while China's property crisis prompted investors to seek safe havens for their capital globally.

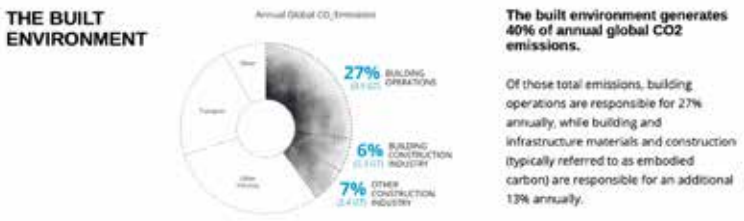
According to Emaar Properties, Dubai's largest developer, Chinese investments in its projects nearly doubled to account for 7% of total sales in the first half of 2023, up from approximately 3% to 4% in the same period a year earlier.

Russian investors also heavily finance the UAE real estate boom. The outbreak of the Russia-Ukraine war and the EU's ban on Russian transactions have led to Russian investment becoming a major source of financing in the UAE real estate market, causing property prices to increase by 47%.

Trends: The Year of Sustainability

While the real estate boom is beneficial for the economy, its timing could have been better. The record-breaking rise in the price and value and value or real estate transactions, and the Conference of Parties 28 (COP28) fast approaching, in less than 8 weeks, the pressure to accelerate the race speed towards Net Zero has quadrupled, becoming the most significant trend and development of this time.

Real Estate has one of the highest carbon footprints contributing 30% of global annual greenhouse gas (GHG) emissions and consumes around 40% of the world's energy[1].



UAE's Unique Roadmap to Achieving Sustainable Building Goals: Different Economy Different Priorities.

Understanding the UAE's economic dynamics reveals why the country is not following the same roadmap to reach net zero as recommended and judged upon by the rest of the world.

While the UN talks about diversity and inclusion, it fails to recognise the diversity of the UAE's economic culture and customs. The UAE culturally and economically adjusts the manner of conducing its trade relations with the world as per their ways, to make them feel inclusive. However, even the masterminds at the UN or World Bank do not consider the evident (the source of real estate financing, for example) and apparent (the community and customs elements of the economy).

UAE's source of Real Estate Finance

Unlike many other countries, equity from sponsors, investment funds, and other institutional investors are not the main source of real estate project financing in the UAE.

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The two key finance sources in the UAE are local banks and owners' equity and capital. Besides the foregoing, the national's six major banks that have a record of funding the most projects are closely connected to the central bank and government executives.
This community style culture is deeply rooted in the economic legal dynamics of the country, and in such cultures, encouraging and respectfully asking banks to make ESG disclosures is no more or less effective than passing mandatory disclosure regulations upon them. There is proof that these banks are undertaking voluntary sustainability disclosures.

1. 2019 global status report for buildings and construction, International Energy Agency, December 2019.

How the UAE is Steering Sustainable Real Estate Goals

There are doubts and fingers pointing at the UN level that UAE is all talk of Net Zero but no 'walk'. But the facts on the ground, and the history of the UAE shows a different trend. The UAE's leadership has a 'first principles thinking' style. Look at the root problem, solve it – dispense all associated noise. Over UAE's legislative lagging

The question being asked by world leaders is, "Who is going to do the checks and balance? What about the risks of greenwashing?[2]"
Whether we like it or not, the UAE shows results as the culture believes in accountability not answerability. **It's going green that matters** –

What we have deciphered from the trends is that UAE is following more or less the below roadmap.

Step 1 – enabling to go green with the right infrastructure. Sustainable Finance Regulations, SCGR and Disclosures are a means to an end, not the end goal.

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> Whether we like it or not, the UAE shows results as the culture believes in accountability not answerability.

The UAE's priority appears to have been the infrastructure. Get that will enable real estate developers to develop sustainable projects.
If the country doesn't have a proper waste management system or solar plants with the capacity to meet its people's energy needs, then any disclosure regulations on investors or green building standards imposed will be simply futile.

As such, one can understand why the country is not following the same path towards the journey to net zero as the rest. UAE's strategic positioning in the global real estate market and its unique socio-economic dynamics play a significant role. The UAE is making the market ready for green investments in two ways:

1. The country has invested billions in renewable energy and waste management projects, which are the two major contributors to the real estate and construction sector's carbon footprint. No green building can be built without national access to clean energy.

2. The UAE has spent more than $40 billion on clean energy over the last 15 years.

Some of the solar power plants already completed or shortly due for completion are:

1. Abu Dhabi's upcoming renewable energy projects, including the (5.6 GW) Barakah nuclear energy plant and the (2-GW) Al Dhafra Solar PV project, will produce a total clean power generation capacity of 8.8 GW by 2025.

2. Shams Solar Power Station (the Abu Dhabi Solar Project) and the Mohammed bin Rashid Al Maktoum Solar Park in Dubai, whose production capacity will reach 5,000 megawatts (MW) by 2030.

3. The UAE is also building the world's largest independent solar power plant, the Al Dhafra Solar PV facility, with a capacity of up to 2 gigawatts (GW) of electricity. The plant aims to reduce the emirate's carbon emissions by more than 2.4 million metric tonnes annually, equivalent to removing some 470,000 cars from the road and providing electricity to over 160,000 homes in the UAE.

4. The fourth phase of the Mohammed bin Rashid Al Maktoum Solar Park, managed by the Dubai Electricity and Water Authority (DEWA), has a capacity of 950 MW under the independent power producer system and is the world's largest Concentrated Solar Power Plant (CSP) plant located in one area. The plant combines CSP and photovoltaic solar energy technologies, and its fourth phase will generate 700 MW of CSP energy and 250 MW of energy from photovoltaic solar panels.

2. To date, however, there have been no mandatory reporting obligations on banks in the UAE with respect to how they consider their sustainability risks and climate change risks in when lending or investing monies. Nor are there any standards or requirements as to which products can be considered as "green" or "sustainable" – this creates a risk of greenwashing and an uneven playing field. NortonRoseFullBright (2021)

5. Emirates Development Bank, the state-owned lender focused on financing the UAE's priority sectors, also launched a Dh100 million ($27.2 million) solar energy finance program as part of the country's 2050 net-zero targets.

Step 2: controlling the goal not the road.

As such, what we see is that the UAE has indeed defined what constitutes 'green' and 'sustainable.' Both Dubai and Abu Dhabi have implemented building codes and regulations on new projects to promote sustainable and green building practices. Here are the notable regulations and standards:

1. Dubai Green Building Regulations & Specifications (DGBRS): Mandatory since 2014, it applies to all new buildings in Dubai and focuses on sustainability aspects including site selection, energy use, water efficiency, and materials and resources.

2. Safat Green Building Rating System: Introduced in 2016, Al Safat replaces the earlier DGBRS for new constructions. It sets requirements in areas such as energy, water, air quality, and waste, and buildings are rated from platinum (highest) to bronze based on adherence to these criteria.

3. Estidama: A building sustainability program initiated by the Abu Dhabi Urban Planning Council, with the most known tool being the Pearl Rating System. It sets mandatory requirements and optional credits in various categories.

4. Pearl Building Rating System (PBRS): Specifically for buildings, it sets requirements and credits in various categories and rates buildings from 1 to 5 pearls.

5. UAE Ministry of Climate Change and Environment issued Decree No. (138) of 2023, regulating the use and distribution of Hydrofluorocarbons (HFCs) in the country to control their circulation and prevent emissions.

The onus of meeting green or sustainability criteria is on the government bodies responsible for issuing permissions and permits, not on financiers. Permissions and permits are only granted if a project meets minimum sustainability requirements.

As of now, the UAE is proactively retrofitting existing buildings and acquiring globally recognized sustainability certifications for new projects:

1. Dubai has completed retrofitting for over 10,000 buildings, improving air quality and public health.

2. Since January 2021, UAE has retrofitted 43 existing buildings.

3. Abu Dhabi has retrofitted 27 existing hospitals, shopping malls, hotels, warehouses, and offices, obtaining LEED Platinum Certification.
4. 504 buildings have received LEED Certification since 2021, with 77 having platinum ratings and over 200 having Gold ratings.

By imposing regulations on developers rather than financiers, the UAE might be following a more efficient path to ensure sustainability in real estate.

More on the Funding side…

Developers have access to financing earmarked for green/ESG-compliant projects, including:

1. Green Sukook bonds:
   a. First Abu Dhabi Bank issued the UAE's first dirham-denominated green sukuk, raising Dh1.3 billion ($353.93 million) in funds.
   b. Majid Al Futtaim Holding raised $500 million through a green sukuk.
   c. Aldar Investment Properties raised $500 million through its debut green sukuk.
   d. Masdar raised $750 million through the sale of 10-year senior unsecured notes for renewable energy projects.
   e. Abu Dhabi Commercial Bank priced a $650 million green bond for financing eligible projects meeting environmentally friendly standards.
   f. Dubai Islamic Bank raised $1 billion from its second sustainable sukuk.

2. Chimera Investment LLC, part of Abu Dhabi's business empire overseen by Sheikh Tahnoon bin Zayed Al Nahyan, set up a $50 billion fund focusing on various investments.

Step 3: Sustainable Finance Framework and Disclosure regulations.

With most of the groundwork on infrastructure and mandatory green building policies already in progress, the UAE is now paving the way for private equity, REITs, and asset managers to benefit from funding sustainable projects without starving developers or losing opportunities. Starting with DIFC and ADGM, the country has mandated disclosure requirements specific to financial service firms.

ADGM Sustainable Finance Framework

After giving precedence to the green construction mechanism, concentrating on infrastructure, and implementing initial disclosure policies tailored to real estate development financiers, the UAE has shifted its focus to regulating the secondary entities overseeing real estate financing, including funds, investment firms, and asset managers.

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> Asset owners will have to maintain clear accounting of proceeds, investment, and returns to enable investors to track sustainability.

With 102 asset managers, consisting of investment firms and hedge funds, collectively managing 128 funds, establishing a presence in the capital's financial centre during the past six months, the Abu Dhabi Global Market (ADGM) emerges as the ideal testing ground for these disclosure and reporting requirements.

The Authority imposes on directors and senior management, the duty to identifying and considering opportunities, as well as any associated risks and threats, afforded by ESG compliant investing. A high level of due diligence should be applied to lending and investments decisions where ESG impacts are material;

ADGM has encouraged stakeholders, including issuers, investors, and the financial industry, to rely on internationally recognised taxonomies for 'sustainable' and 'green' products and instruments until an appropriate taxonomy is adopted in the UAE.

Asset owners will have to maintain clear accounting of proceeds, investment, and returns to enable investors to track sustainability. Information on the use of proceeds should be up to date, recorded, disclosed, and reported. Annual reviews of the post-issuance allocation of proceeds of a green sustainable project will be conducted, along with assessments of the impact on sustainable goals and climate-related risks by rating agencies.

In conclusion, the UAE's real estate sector is undergoing a significant transformation in the context of sustainability.

The government's focus on infrastructure, sustainable building standards, and innovative financing options is setting the stage for a more sustainable future in real estate. By regulating developers and incentivising green practices, the UAE aims to make a lasting impact on the industry while addressing the challenges of sustainability and carbon reduction.





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