THE REAL ESTATE M&A AND PRIVATE EQUITY REVIEW

SEVENTH EDITION

Editors
Adam Emmerich and Robin Panovka

THE LAWREVIEWS

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CONTENTS

PREFACE

For real estate investment trusts (REITs), the covid-19 pandemic was a tale of two cities, of boom and bust, with the seismic changes in the world leading to strength in some sectors of commercial real estate and huge market dislocations and disruptions in others. In general, companies with assets that service the digital economy – cell towers, logistics and industrial properties, and data centres – benefited from the pandemic's acceleration of the digital economy. However, several traditional sectors confronted difficult issues involving liquidity, rent collection, dividend payouts, disclosure and guidance, as well as having to navigate the uncertain and sometimes shifting guidance from regulatory authorities regarding the timeline of reopening. While the distribution of the vaccine to many individuals in the United States and certain other countries has blunted the pandemic in some areas, inequitable distribution has yielded an uneven economic recovery internationally. Still, even with hopefully the worst of the pandemic behind us, we are unlikely to see a return to a pre-pandemic world, as the pandemic has changed the way that we interact with real estate, and compressed a decade or more of digitisation into a matter of months, with the new normal involving fewer, or at least different, in-person work or shopping. While vaccine rollouts have enabled many regions to fully reopen stores, offices and restaurants, we still have longer to wait to find out how many of the pandemic shifts (work from home and hybrid work arrangements, massive growth in online retail) are permanent, and which will fade with time. The eventual new normal that emerges will likely have rippling effects throughout the REIT industry for years to come. As always, strategic planning and risk management will be critical to adjust to changing times. Covid-19 aside, 2022 has brought some storm clouds, with war in Europe, rising interest rates and inflation running hot. While opportunities within real estate are unlikely to dry up, there may be increased volatility in the near term, and the complex macroeconomic backdrop will likely have disparate impacts on different subsectors and different geographies within the industry.

Stepping back from recent global events and market dislocations, publicly traded real estate companies and REITs, with help from real estate private equity, have steadily transformed the global real estate markets over the past 25 years. Their principal innovation, and 'secret sauce', has been liquid real estate. Unlike traditional property ownership, equity in publicly traded real estate vehicles is highly liquid, and can be bought and sold in large volumes, literally in minutes, on numerous global exchanges. Indeed, during the pandemic, REITs issued more than US$10 billion in public equity, taking advantage of the massive amounts of liquidity washing over financial markets beginning in the spring of 2020. In 2021, public REITs raised approximately US$27 billion in follow-on equity offerings.

Publicly traded real estate vehicles have an aggregate market capitalisation of over US$1.6 trillion globally, including over US$1 trillion in the United States and approximately

US$200 to US$280 billion in each of Europe and Asia. As public REITs and other vehicles have aggregated these properties and grown in scale and sophistication, so too have real estate-focused private equity funds, playing an important role catalysing hundreds of billions of dollars of REIT and real estate merger and acquisition (M&A) transactions and initial public offerings.

However, despite that massive growth and despite the pandemic, potential growth is far larger both in long-standing REIT markets and in newer REIT jurisdictions, where the trend is more nascent. With increasing development and urbanisation, the world is producing more and more institutional-grade properties, and a growing percentage of this expanding pool – an estimated US$5 trillion and counting – will inevitably seek the advantages of liquidity by migrating to the publicly traded markets. The growth is expected to be both local and cross-border, with nearly 40 countries already boasting REIT regimes. Despite this potential for growth, it remains to be seen whether Russia's invasion of Ukraine and the associated energy and supply chain disruptions will spur a wider backlash against globalisation and cross-border investment.

REITs and other publicly traded vehicles for liquid real estate have grown because they are often a superior vehicle for stabilised assets. Greater liquidity and transparency – and often superior governance – are attractive to investors, resulting in a lower cost of capital and superior access to vast amounts and varieties of capital in the public markets. In addition to cheaper capital, REITs and other public vehicles benefit from efficiencies of scale, sophisticated management and efficient deal structures, to name just a few advantages. With these advantages, the global march of real estate to the public markets seems unstoppable.

This publication is a multinational guide for understanding and navigating the increasingly complex and dynamic world of liquid real estate and the transactions that mostly produce it. The sea change in the markets, sometimes called the 'REIT revolution', has meant that major real estate transactions have migrated from 'Main Street' to 'Wall Street'. They now often take the form of mergers, acquisitions, takeovers, spin-offs and other corporate transactions conducted in the public markets for both equity and debt. They have grown exponentially in complexity and sophistication, and increasingly represent cross-border multinational transactions fuelled by the now-global real estate capital markets and M&A deal professionals. And they are often intermediated by international investment banks rather than local brokers, and financed with unsecured bonds or commercial mortgage-backed securities. In a fair number of cases, they are catalysed by private equity firms or similar actors, sometimes building portfolios to be taken public or sold to public real estate companies, and sometimes through buyouts of public real estate companies for repositioning or sale.

To create this publication, we have invited leading practitioners from around the globe to offer practical insights into what is going on around the conference tables and in the markets in their jurisdiction, with an eye to cross-border trends and transactions. As will quickly become evident, the process of liquefying real estate and transactions involving public real estate companies requires a melding of the legal principles, deal structures, cultures and financial models of traditional real estate, public company M&A and private equity. None of this, of course, happens in a vacuum, and transactions often require expertise in tax, corporate and real estate law, not to mention securities laws and global capital markets. Each of our distinguished authors touches on these disciplines.

We hope this compilation of insight from our remarkable multinational authors produces clarity and transparency in this exciting world of liquid real estate and helps to further fuel the growth of the sector.

Adam Emmerich and Robin Panovka
Wachtell, Lipton, Rosen & Katz
New York
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Chapter 8

LUXEMBOURG

Julien Lecler, Veronica Aroutiunian and Tom Hamen[1]

I OVERVIEW OF THE MARKET

Development of the real estate market in Luxembourg

Originally, Luxembourg was an agricultural country, but the discovery of iron ore around the mid-19th century as well as the development of a powerful iron and steel industry made the wealth of the Grand Duchy until the 1970s and the sudden impact of the global crisis.

Aware of the risk of relying on only one sector, the political authorities had been working towards industrial diversification since the 1960s, and this is still ongoing.

These actions have been highly successful; today, the financial sector is the main driver of Luxembourg's economy. The financial centre is thus one of the top international financial centres, and Luxembourg's fund industry is the largest in the European Union and the second-largest in the world, just after the US.

In that context, the Grand Duchy has become the leading domicile in Europe for vehicles investing directly or indirectly in internationally diversified real estate portfolios.

Besides, on the asset side, its demographics, strategic geographical position as well as political and economic stability have had a huge impact on Luxembourg's real estate market development, and this is expected to continue. The demand has even been reinforced these past few years due to Brexit and the arrival of some players of the financial and insurance sector as well as their employees. The pandemic and homeworking have obviously impacted the market, which has, however, kept a strong dynamic so far despite the recent uncertainties related to the consequences of the high inflation period we have just entered.

Luxembourg real estate market: asset side

In 2021, real estate transactions on the capital market reached approximately €1.57 billion, spread over approximately €770 million standing investments; €680 million development and redevelopment; and €86 million occupier and owner.[2]

The investment market showed a strong dynamic at the beginning of 2022. This good show of activity of developers demonstrates their confidence in the market to date.[3]

1 Julien Lecler is a counsel, Veronica Aroutiunian is a partner and Tom Hamen is a senior associate at Loyens & Loeff.

2 Office Market Report Luxembourg 2021, Inowai.

3 Market Outlook 2022, CBRE Luxembourg.

2020 saw 208 deals signed for 320,000 square metres (m^2) of Luxembourg office space, Luxembourg being the only EMEA country showing year over year growth in transaction volume (+25 per cent).[4]

The Luxembourg office market was resilient to many pandemic concerns, closing with a record take up of 369,300m^2 for 2021.

The pipeline is indicating another good year so far for the office market, while take up is unlikely to reach last year's record.[5]

The retail market recorded more than 11,400m^2 of new deals in one of the highest volumes over the past decade. Retailers secured a strong 17,200m^2 of space in out-of-town locations, and 6,400m^2 for shopping centres. With commuters largely returning to Luxembourg and the belief that the worst of the pandemic is behind us, there is a certain level of optimism in the market, which could be hit by the high inflation situation.[6]

The residential rental markets experienced a recovery in activity in 2021, as international workers began returning to Luxembourg after a long period of homeworking. This is mostly evidenced by the decreasing commercialisation period of rentals, particularly in the €1,300 to €2,500 m^2/month range in the city. Average purchase prices for the Grand Duchy increased 11.8 per cent year over year to €651,875 (8,166/m^2). The increase is most apparent in existing apartments (+15.5 per cent) versus new builds (+6.2 per cent). Luxembourg City experienced a 10 per cent increase for existing apartments to €10,897m^2 and 6.1 per cent for new construction to €12,206m^2.[7] Prices seem to have reached a kind of plateau, and uncertainties about the economic context, mainly driven by inflation, might maintain this situation despite strong demand. Political authorities are also working on various measures and plans to foster the production of affordable housing, which will probably enter into force in the coming years.

II RECENT MARKET ACTIVITY

i M&A transactions

No specific market or transactional information must be reported.

ii Private equity transactions

The most significant private equity transactions of the past few years to be reported are summarised below.

Laccolith

In 2020, Primonial acquired from Deka Immobilien Investment, in a share deal, the Laccolith building, a 13,000m^2 office building located in the Cloche d'Or district and mainly leased by the European Commission. The transaction was the biggest transaction on the real estate market in 2020.

4 Luxembourg Office Market, Annual Research Report 2020, JLL.
5 Market Outlook 2022, CBRE Luxembourg.
6 Market Outlook 2022, CBRE Luxembourg.
7 Market Outlook 2022, CBRE Luxembourg.

Altitude

In April 2020, a French institutional investor carried out the acquisition, in a share deal, of the real estate complex Altitude in Leudelange from the Belgian developer Codic and the Luxembourgish developer Tralux.

H2O

In 2021, Lone Star acquired the 28,000m^2 H20 office asset in Howald, from Nomura, Asia's global investment bank. The transaction was the biggest transaction on the real estate market in 2021.

The Stage

In the last quarter of 2021, Real IS acquired, in an asset, The Stage building, a 14,000m^2 office building leased to the European Investment bank and Pictet Bank, from Batipart.

The Arc

In the last quarter of 2021, Real IS also acquired, in a share deal, The Arc office building, located near the train station in Luxembourg, in a forward sale, from the developer Eaglestone.

Icone

In March 2022, the Belgian developer Besix sold, in a share deal to AG Insurance, the Icone building, located in Belval, which will host the new headquarters of Société Générale. The transaction is, so far, the biggest transaction on the real estate market in 2022. The transaction was structured as a forward sale (see below).

III REAL ESTATE COMPANIES AND FIRMS

i Publicly traded REITs and REOCs – structure and role in the market

Absence of publicly traded REITs and REOCs

Luxembourg has neither a REITs regime nor publicly traded REOCs.

ii Real estate PE firms – footprint and structure

Real estate investment funds (REIFs) are predominantly structured using the following fund regimes:

a specialised investment fund (SIF), governed by the Luxembourg law of 13 February 2007 relating to specialised investment funds (SIF Law);

b reserved alternative investment fund (RAIF), governed by the Luxembourg law of 23 July 2016 on reserved alternative investment funds (RAIF Law);

c investment company in risk capital (SICAR), governed by the Luxembourg law of 15 June 2004 relating to the investment company in risk capital (SICAR Law);

d unregulated alternative investment fund structured as a common or special partnership (unregulated AIF partnership), governed by the Luxembourg law of 10 August 1915 on commercial companies (Company Law); and

e undertakings for collective investment governed by Part II of the Luxembourg law of 17 December 2010 relating to undertakings for collective investment (Part II UCI).

Except for the unregulated AIF partnership, which is a manager-regulated product, and RAIFs, all the other Luxembourg REIFs formed under the above-listed regimes are regulated funds and require prior approval of the Luxembourg Commission de Surveillance du Secteur Financier (CSSF). In addition, REIFs can take different legal forms and be set up using different structures.

Regulatory regimes

The 2021 annual Real Estate Investment Funds Survey by the Association of the Luxembourg Fund Industry (ALFI) reveals that the SIF regime is the favoured regulatory regime for REIFs in Luxembourg. On the other hand, the Survey reports a significant and continuous increase of RAIFs, which is a very popular regime for real estate focused investment funds. The main difference between the SIF and the RAIF is that the RAIF is not subject to direct supervision of the CSSF and therefore allows more flexibility in terms of time to market as there is no need for prior regulatory approval to launch such fund. Otherwise, both regimes are very similar (if not identical).

The SIF and the RAIF are not subject to any restrictions in terms of eligible assets, subject to a risk diversification requirement. They may invest in property consisting of land or buildings, or both, registered in the name of the SIF or RAIF; and equity or debt instruments, or both, issued by real estate companies whose exclusive purpose is the acquisition, promotion and sale as well as letting and tenanting of real estate as well as various long-term real estate-related interests such surface ownership, lease holds and option rights on real estate assets. In general, the risk diversification is complied with if a SIF or RAIF does not invest more than 30 per cent of its assets or subscription commitments into a single property or the same property right or the same issuer of property rights. In practice, a ramp-up period of up to four years can be foreseen during which the diversification requirement does not apply yet. Neither the SIF nor the RAIF are subject to any borrowing restrictions.

In terms of capital raising, both the SIF and the RAIF are reserved to well-informed investors: that is, investors who are institutional investors, professional investors or investors that declare their adherence to the status of well-informed investor and either invest at least €125,000 in a SIF or RAIF or produce an attestation from a regulated bank or an investment firm certifying such investor's expertise, experience and knowledge to appraise in an appropriate manner an investment in a SIF or RAIF. A RAIF must be managed by a European authorised alternative investment fund manager (AIFM), and hence benefits from the European passport to raise capital from professional investors in the European Economic Area (EEA). A SIF may be structured either as an alternative investment fund (AIF) or a fund not qualifying as an AIF and, if structured as an AIF, may be managed either by an authorised or a registered AIFM. If managed by an authorised AIFM, a SIF also benefits from the European passport to raise capital from professional investors in the EEA. Raising capital from high-net-wealth individuals qualifying as well-informed investors requires a country-by-country analysis in terms of target jurisdictions.

The growing trend of 'retailisation' of alternative investment funds is currently causing a comeback of Part II UCIs. The main difference to the SIF and RAIF regimes is that a Part II UCI can be offered to retail investors (in compliance with applicable local rules). a Part II UCI is subject to a stricter diversification rule than the SIF or RAIF: it may not invest more than 20 per cent of its net assets in a single property, such a restriction being effective at the date of acquisition of the relevant property (subject here again to a ramp-up period of a maximum of four years). The aggregate of all borrowings of a REIF structured as a Part II UCI may not exceed on average 50 per cent of the valuation of all its properties. Similar to a SIF, the Part II UCI cannot be established without prior CSSF authorisation. Similar to a RAIF, a Part II UCI is an AIF by law and must appoint either a registered or authorised AIFM (depending on the total assets under management of the manager).

Less popular for real estate assets, the SICAR is a customised vehicle originally conceived for investment in venture capital. Similar to a SIF, it may or may not be structured as an AIF and is subject to direct supervision by the CSSF. SICARs are not subject to any diversification requirements. However, a REIF can only be structured as a SICAR if the target real estate investment is considered as risk capital. Such an investment must be made through special purpose vehicles as a SICAR cannot acquire real estate directly. Eligibility criteria for target real estate investment is based on the concept of development. The SICAR regime is used to implement value-enhancing real estate strategies where the purpose is to achieve high yields through development or repositioning of properties. A SICAR may not be used to make a long-term, passive investment in stabilised real estate assets.

Finally, REIFs that are not subject to any product-specific laws are often structured as unregulated AIF partnerships with or without legal personality. Unregulated AIF partnerships are popular because they can be set up very quickly (without prior CSSF approval) and offer extreme operational flexibility (being very similar to Delaware or Cayman limited partnerships). They are not subject to any investment or borrowing restrictions and, if managed by a European authorised AIFM, they can raise capital from professional investors in the EEA using the European passport of their manager.

Legal forms

All of the above fund types (except for unregulated AIF partnerships and SICARs) may be organised under any of the following three categories:

a Common fund (FCP): this is a contractual type fund that is not a legal entity. An FCP is a co-proprietorship of assets that are managed on behalf of the joint owners (investors) by a management company that takes all the decisions relating to the investments and operations of the FCP. Investors subscribe for units, which represent a portion of the net assets of the FCP, and they are only liable up to the amount they have contributed. Rights and obligations of unitholders are defined in the management regulations, and they only have voting rights to the extent provided for in the management regulations.

b Investment company with variable capital (SICAV): this is a corporate type fund that has a legal personality (unless formed as a special limited partnership). The SICAV acronym means that the capital is increased or reduced automatically as a result of new subscriptions or redemptions without requiring any formalities such as shareholders' approval or intervention of a notary. A SIF or RAIF structured as a SICAV can adopt any corporate form, whereas a Part II UCI structured as a SICAV can only take the form of a public company (SA).

c Investment company with fixed capital (SICAF): this is a corporate-type fund that has a legal personality and is subject to specific formalities in terms of variation of its capitalisation (unless formed as a special limited partnership).

According to the 2021 ALFI survey, SICAVs remain the preferred choice in terms of legal structure.

REIFs (other than those structured as unregulated AIF partnerships) may further be organised as single funds or as umbrella (multicompartment) funds. An umbrella fund is composed of one or more compartments each of which is linked to a specific portfolio of investments that are legally segregated from the investment portfolios pertaining to the other compartments. This is the ring-fencing principle. The umbrella fund constitutes one single legal entity (SICAV/SICAF) or contractual arrangement (FCP); however, the assets of each compartment can only be used to satisfy the rights of investors in that particular compartment and the rights of creditors whose claims have arisen in connection with the operation of that particular compartment. Within an umbrella fund, compartments may have different investment policies or be restricted to certain types of investors, or both (e.g., for a co-investor).

In addition, it is also possible to create various classes of units or shares in the REIF organised as a single fund or within each compartment of an umbrella REIF. Such classes of units or shares may differ, inter alia, as to their fee structure, distribution policy and type of investors, or track the performance of a specific underlying asset.

Trends and challenges

The overall trend observed over the past several years is that the Luxembourg REIFs are leaning towards simplification of structures and strategies. Unless structured as SICARs, which by definition are opportunistic, Luxembourg REIFs predominantly pursue a core strategy, with continuous and significant growth in core plus funds, focusing on more than one sector.

Although the ALFI survey indicates a constant increase in closed-ended funds, the growing interest of the wealth management industry in alternative assets is expected to drive the number of open-ended unitised REIFs up for years to come. In this respect, one of the key challenges for REIFs remains liquidity management, recently brought back into focus by the European Commission in the context of the review of the Alternative Investment Fund Managers Directive (AIFMD II). Under AIFMD II, AIFMs managing open-ended AIFs will be able to temporarily suspend redemptions by using one of the liquidity risk management tools set out in Points 2 to 4 of Annex V to AIFMD II, which sets out a minimum list of liquidity management tools that should be available anywhere in the EU and will be further developed via regulatory technical standards from ESMA. The tools include notice periods, redemption fees, an anti-dilution levy and swing pricing. Temporary suspensions will only be permitted in exceptional circumstances where this is justified and in the interests of investors. The AIFM will be expected to implement detailed policies and procedures in relation to the activation and de-activation of selected liquidity management tools, as well as associated operational and administrative arrangements. AIFMs will be required to notify the competent authorities about activating or de-activating a selected liquidity management tool.

Finally, a key trend and challenge over recent years has been investors' and the industry's growing interest in environmental, social and governance (ESG) matters. The European Union's goal to become climate neutral by 2050 has been recently translated into a regulation (Taxonomy Regulation) aiming at making it easier to determine the ecological sustainability of an investment and stimulate the reorientation towards sustainable finance. As a consequence of the Taxonomy Regulation and the related disclosure regulation (SFDR), significant opportunities are emerging, along with challenges that REIFs need to consider, as these regulations introduce new transparency obligations for financial products. In this context, sustainability is becoming a critical aspect with a direct impact on properties and investments. In the future, higher demand and better financing conditions are likely expected for properties and investments offering a higher level of sustainability, with the Taxonomy Regulation sustainability criteria expected to become key factors in value creation.

IV TRANSACTIONS

i Legal frameworks and deal structures

Subject of the deal

The majority of real estate transactions relate to existing and completed buildings.

However, there is an upward trend in acquiring real estate developments in the future state of completion no matter the investment sector (office, retail, healthcare, residential or warehouse). This kind of transaction can be structured either as a forward purchase or a forward funding. Their names are similar; their operations, however, are different.

In a forward purchase structure, the parties agree to sign a sale and purchase agreement, either for the shares of the company owning real estate under development or for the real estate itself (see below), under the condition precedent of the completion of the works (being in most cases the provisional acceptance). Transfer of ownership therefore occurs only after provisional acceptance, meaning that the investor-buyer will neither bear the construction risk nor the risk of insolvency of the developer-seller. This could also ease the financing of the transaction, such financing being most of the time negotiated before signing but with a draw-down only on completion.

In a forward funding structure, the parties agree to sign a sale and purchase agreement, either for the shares of the company owning real estate under development or for the real estate itself, without a condition precedent of completion of the works. To mitigate the risk for the investor-buyer, parties usually agree on a condition precedent of definitive permits. Contrary to the forward purchase, the sale – and thus the transfer of ownership – occurs prior to the completion of the construction works and the price is paid upfront, most of the time in instalments over the construction process. It also means that, except for the regulated forward funding under the law, the parties have to contractually agree on the process and allocation of risks during the entire construction process.

Structure of the deal

A real estate transaction is structured either through an asset deal or a share deal.

In the case of an asset deal, the subject of the transaction is the asset itself. In the case of a share deal, the transaction concerns the acquisition by the purchaser of the shares issued by a company holding the asset.

Both structures are observed in Luxembourg. However, the majority of the transactions in Luxembourg are structured as a share deal mainly because share deals are not subject to real estate transfer taxes.

ii Acquisition agreement terms

Letter of intent

Real estate transactions usually start with the negotiation and the execution of a letter of intent containing the most important commercial and financial parameters of the transaction, referring to the envisaged steps until closing of the transaction and granting to the candidate purchaser an exclusivity period.

Sale agreement

The sale agreement usually contains conditions precedent, representations and warranties, indemnification clauses and covenants. The content of the sale agreement also reflects the outcome of the due diligence exercises performed by the purchaser's advisers for the technical, legal and tax aspects.

Imported from the UK market, an upward trend is warranty and indemnity (W&I) insurance, which covers undisclosed risks for the period prior to closing. Parties usually negotiate their terms of acquisition and then provide the purchase agreement to an insurance broker. The insurance company usually reviews the agreed representations and warranties to, as the case may be, exclude some from the insurance coverage. Usual exclusions concern the condition of the properties, certain environmental matters and transfer pricing.

The market is currently experiencing the development of tax insurance to guarantee identified risks – most of the time at the exclusion of transfer pricing. In such process, (at least) the purchaser must provide the insurance with a robust defence memorandum stating the arguments in favour of the taxpayer and the likelihood of success in the case of litigation.

Asset deal

A real estate transaction is often completed in two phases.

a The parties enter into a private sale agreement. The content of such agreement is freely determined by the parties. Once completed, the agreement is valid and enforceable between the parties. However, the sale contemplated on the private sale agreement is not enforceable towards third parties.

b For this reason, the transfer of ownership contemplated in the private sale agreement needs to be recorded to the Mortgage Register. To do so, the sale must be enacted in a deed to be signed before a notary public.

Share deal

Share deal real estate transactions are subject to only one document: a share purchase agreement (that does not need to be recorded or enacted in a notarial deed).

iii Financing considerations

There are three layers of financing: the financing of the fund; the acquisition financing, typically to acquire the shares or the target; and the real estate financing or refinancing with the target as borrower.

Real estate financing will first depend on the leverage capacity of the target company; for both corporate law and tax law reasons, it is indeed not possible to over-leverage a company. Up to this leverage capacity, the company acts as borrower and grants a market standard collateral package that includes mortgage, pledge of receivables (e.g., rent receivables, insurance receivables) and pledge of bank accounts. The shareholder usually pledges the shares of the target company and subordinates any intragroup loans.

iv Tax considerations

As a matter of general principle, real estate income (be it current income or capital gains) is taxed in the country in which the real estate is situated.

Real estate situated in Luxembourg

The tax treatment of income from real estate situated in Luxembourg depends on the investor.

Assuming the real estate is owned by a Luxembourg company, any real estate income is subject to ordinary Luxembourg corporate income taxation at an aggregate rate of 24.94 per cent (for companies having their registered office in Luxembourg City, for the tax year 2022). On top of that, the unitary value of the real estate is subject to an incremental net wealth tax charge at a rate of 0.5 per cent for a company having a net wealth below €500 million and at a rate of 0.05 per cent applied to any excess. Luxembourg property companies can, subject to certain limits and exceptions, deduct general operating expenses and interest expenses as well as depreciation charges from their taxable basis.

Transfers of real estate situated in Luxembourg by way of an asset deal can be subject to registration and transcription duties at a maximum rate of 10 per cent. Share deals are not subject to registration and transcription duties.

Real estate situated outside Luxembourg

Investors can invest into real estate situated outside of Luxembourg. Based on its extensive double tax treaty network, Luxembourg should generally not have the right to levy tax over the income derived from or the net wealth allocable to such real estate.

Luxembourg as an investment jurisdiction

Luxembourg has become the default jurisdiction for real estate investments and investment funds. Fund managers frequently set up Luxembourg pooling vehicles, such as SIFs, RAIFs, UCITs or unregulated partnerships, as investor-facing entities. If properly structured, no material tax leakage should occur at the level of these pooling vehicles. Luxembourg fund vehicles are generally not subject to withholding taxation in Luxembourg.

Since 2021, Luxembourg has levied a 20 per cent tax on certain types of income realised by certain tax-opaque investment entities that invest into real estate situated in Luxembourg. This levy does not apply for investments into real estate located abroad.

Luxembourg is also frequently used as a jurisdiction of choice for the establishment of intermediate holding, joint venture or acquisition vehicles. In general, these entities are organised as private limited liability companies and are regular taxpayers in Luxembourg. When properly structured, they should not be subject to a material tax burden in Luxembourg. Different from investment funds, Luxembourg holding companies are subject to withholding taxation in Luxembourg. However, a wide range of exemptions or rate reductions are available. In addition, at arm's-length interest payments, loan principal repayments or liquidation distributions are not subject to Luxembourg withholding taxation.

It should be noted that Luxembourg does currently not offer a specific tax regime applicable to REITs.

Finally, even though Pillar II and ATAD 3 are not yet in force, their implementation in Luxembourg should be closely monitored as both pieces of legislation are expected to have an impact on the tax treatment of typical real estate investment structures.

v Cross-border complications and solutions

Besides EU AML requirements and EU sanctions, on 16 September 2021, the Luxembourg legislator announced a bill of law to implement foreign direct investment (FDI) measures and to introduce a screening mechanism for FDI that may adversely affect national security or public order in Luxembourg. As per the bill of law, the prior approval mechanism will apply to FDI in a Luxembourg entity carrying out critical activities in Luxembourg that may adversely affect national security or public order.

V CORPORATE REAL ESTATE

The current trend in corporate real estate is based on asset classes, and not on the type of investor. For the hotel and leisure and (care) housing sectors, the trend is to separate the opco and the propco, with the investor keeping the propco and the opco being carved out, most of the time via a regular sale of the business. A standard (long-term) lease agreement is then concluded between the opco and the propco. Specifically for the hotel sector, nevertheless it remains frequent to see one single structure, with the operation being taken care of via a hotel management agreement.

VI OUTLOOK

The current market challenges for both public and institutional actors are the increase of the interest rate, the increase of the construction costs and the increase of the indexation. It remains to be seen to what extent these will influence activity, but the current feverish pitch of the market suggests that a slowdown in activity will occur following the summer.

Appendix 1

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JULIEN LECLER

Loyens & Loeff

Julien Lecler is a counsel of the real estate practice group in Belgium and Luxembourg. He focuses on all aspects of real estate law (civil law, rights *in rem*, construction law, leases) including public real estate law. Julien has considerable experience in all aspects of real estate law (civil law, rights *in rem*, construction law and leases) and has also particular experience in public real estate law, advising clients on town planning and environmental law issues. This experience enables him to advise clients during all steps of a real estate development, including zoning, permits, soil issues, construction and leases. The scope of his work ranges from advice to litigation, including negotiations and the drafting of legal documentation. Julien is also regularly involved in real estate transactions (both asset and share deals), managing the deals from the initial offer to closing, as well as important property developments.

VERONICA AROUTIUNIAN

Loyens & Loeff

Veronica Aroutiunian is a partner of the investment management practice group in Luxembourg. 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. Veronica specialises in fund structuring, with a special focus on private equity, real estate and infrastructure 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). Before joining Loyens & Loeff, Veronica served as an associate in the financial services and investment management departments of various top-ranked law firms in Luxembourg. In the early stages of her career, she gained broad experience in funds with liquid strategies (hedge funds) and retail investors (such as UCITS).

TOM HAMEN

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Tom Hamen is a senior associate of the tax practice group in Luxembourg. He focuses on international and real estate tax matters. Tom specialises in international tax law with a focus on cross-border transactions and restructurings. He also advises on Luxembourg and international real estate tax matters. He is a member of the firm-wide Loyens & Loeff Region Team Germany and increasingly serves the German-speaking market.

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