Developments in relation to Irish Real Estate Funds

DILLON EUSTACE

DUBLIN CORK BOSTON NEW YORK TOKYO

DEVELOPMENTS IN RELATION TO IRISH REAL ESTATE FUNDS

Introduction

We have set out below in summary format the key changes which we have managed to negotiate with the Irish Financial Regulator over the last number of months which we think will lead to a much brighter future for the development of regulated real estate funds in Ireland.

Please note, however, that what is detailed below applies for the moment only to qualifying investor funds ("QIFs") and not to professional investor funds or retail funds.

The principal changes that we have negotiated are as follows:

Property and Property Related Assets

The definitions of "Property" and "Property Related Assets" in the Financial Regulator's current property notice (NU18.3) will not apply to QIFs and, instead, far broader definitions can be given with no limitation on tenure, on minimum unexpired lease term or on the type of interest in land or building that can be acquired. Property derivatives will be allowed (provided appropriately explained/disclosed) and exposures taken via companies, partnerships, trusts or other forms of collective investment scheme, regulated or unregulated etc. can be provided for.

Loans by Real Estate Funds

In the past, it was only permissible for funds to make loans to wholly owned subsidiaries but now the Financial Regulator has clarified its position that it is also willing to permit loans made as an investment provided linked to some element of equity investment. We explained to the Financial Regulator that it may be the case that, for tax or other structuring reasons (including for exit purposes), one might invest Euro 1 as equity and Euro 99 as debt (in the form of a loan or another debt instrument). The Financial Regulator has accepted this and does not consider it to breach the general prohibition on funds making loans.

Joint Venture and Co-Investor Arrangements

The Regulator has finally made it clear that it has no objection to joint venture arrangements, co-investment arrangements or any other form of investment where the Fund invests along with or side by side with other investors in a particular investment (i.e. where it does not hold 100% of either the investing vehicle or of the investment). However, they will treat such an investment in the same manner as if the Fund were investing in an unregulated collective investment scheme so that, while there is no aggregate limit on the exposure to such joint ventures or co-investment or other types of investment scheme/arrangement, the maximum exposure to any one such joint venture or co-investment arrangement etc. will be 40% of net assets. You should note that we have objected to the figure being based on net assets given the leverage employed in such products and we hope that this will be reconsidered by the Regulator in due course but for the moment it is a net assets figure.

Relaxation of Legal/Management Control Rules

The Regulator has reconfirmed that it does not apply the prohibition on taking legal/management control of issuing bodies to investments in intermediate vehicles such as companies, partnerships or trusts etc. that are simply intermediate vehicles through which investment has been made (whether wholly owned or not). More importantly, it has confirmed that it will disapply the general rule prohibiting the taking of legal/management control in the case of a property fund investing in for example property companies provided that that would be a generally passive investment and would not involve the Fund itself in running the day to day management of such property companies.

Layering of SPVs

In relation to the use of wholly owned intermediate vehicles (we are talking about wholly owned subsidiaries, wholly owned SPVs, trusts, limited partnerships etc.) the Regulator used to impose a limit that you could only have one layer of subsidiary below the Fund. They now have confirmed that you can have as many layers as you wish and that the Regulator will not impose any limit on the numbers of layers, the key requirement being one of disclosure (i.e. disclosing the fact that there may be layers of subsidiaries, the fact that there might be additional costs involved and that this may lead to a less transparent investment structure). This is to allow for, for example, investing by an Irish fund through an Irish wholly owned subsidiary into the shares of a Swedish company which in turn invests into a Luxembourg company which in turn invests into a Bulgarian holding company and then into a Bulgarian property. Additionally, prior approval for the use of such wholly owned vehicles will not be required. The Regulator will set out a series of principles to follow and once followed no prior approval will be needed.

Development Land Restriction Clarifications

Whilst the restriction of 50% of gross assets in "development land" remains, the Regulator has clarified that this relates to green field sites and development projects/significant redevelopment and does not include the holding of vacant buildings or general refurbishment. We are also of the view that, whilst we would like this restriction fully removed, it is something which can be overcome by the vast majority of funds (other than those which wish to be exclusively exposed to speculative opportunities). We feel that it is unlikely that most funds will have all of their eggs in the development basket and it is likely that where they are engaged in development they will be near completing one development before they start engaging in another so therefore the rule should not be difficult to comply with.

Independent Valuer Disclosure Changes

Details of the independent valuer no longer have to be disclosed in the prospectus provided that there is an appropriate disclosure in the periodic reports (semi-annual/annual reports). One can have more than one independent valuer per portfolio.

Title to Real Estate Assets – Key Change

Probably the key change has been in relation to the holding of title to property assets. Up until very recently the requirement has been, as the case for all Irish domiciled regulated collective investment schemes, that title to property had to be held in the name of the custodian or within its sub-custody network. You are aware of the concern that this was causing trustees/custodians due to their perception of potential liability for environmental claims, for asbestos related claims, for public liability in certain circumstances etc. in excess of the value of the Fund/insurance cover. The Regulator has now confirmed that it is willing to allow the title to property to be held in the name of the Fund itself or in the name of an SPV (including on a layered basis) provided that either

(i) a restriction be imposed on the title (i.e. to the effect that title cannot be disposed of without the prior consent of the Custodian); or

(ii) a caution be registered on the title (i.e. to give notice to the Custodian of a proposed dealing in the property/to warn prospective purchasers that the prior consent of the Custodian would be required);or

(iii) if neither (i) nor (ii) are possible, the Fund must undertake that it will not invest in real estate assets unless the Custodian is satisfied (x) that the property cannot be cannot be disposed of without its prior consent or (y) that arrangements equivalent to those set out in (i) or (ii) above are in place.

In relation to (iii) above, this is intended to include (but not be limited to) a situation where the Custodian is satisfied that, because it/its sub-custodian/lawyers etc. hold the physical title deeds, the property cannot be disposed of without its consent.

This is a significant development as not only does it create flexibility but it also sets out clear parameters which we feel is better than other jurisdictions where they only allude to title arrangements in their rules leaving uncertainty/ambiguity.

Information Memorandum/Prospectus Directive

The final point that we have managed to negotiate in the last number of days is a clear position adopted by both the Financial Regulator (after various departments within the Financial Regulator had signed off) and by the Irish Department of Enterprise Trade & Employment (the government department responsible for the implementation of the Prospectus Directive), to the effect that the Irish Regulator will be willing to authorise as regulated collective investment schemes true closed-ended collective investment schemes which can and do avail of one or more of the exemptions from the Prospectus Directive (from the requirement to issue a prospectus). Instead of issuing a prospectus, they will issue an "Information Memorandum". The Financial Regulator will apply its rules on the information which it requires for a prospectus to an Information Memorandum thereby giving it comfort that it can actually regulate the offering made by such a vehicle and therefore allow it to remain within the regulated collective investment scheme regime and therefore also importantly retain the benefit of the current Irish tax regime for funds.

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