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Steven L Wilner

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GETTING THE DEAL THROUGH

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1 What is the typical structure of a real-estate-related business combination?

Real-estate-related business combinations or disposals can range from (i) the acquisition of the shares in an English private limited, or offshore, company or group of companies holding one or more real estate assets by way of private tender contract or public offer for, or scheme of arrangement involving, the shares in the holding company of the group, to (ii) a business asset acquisition of property that may be operated as a business (eg, a hotel with employees and commercial contracts), thereby requiring a business acquisition agreement rather than a standard property contract. Other types of real-estate-related business combinations can involve (iii) the acquisition of membership or partnership interests in a limited liability partnership or general or limited partnership or (iv) a reorganisation of a group of companies by way of a demerger involving a distribution in specie or reduction in capital along with a transfer of shares in a subsidiary to a new owner or a liquidation scheme under section 110 of the UK Insolvency Act 1986.

Share purchase real-estate-related business combinations are generally the easiest to structure as the underlying real estate assets do not change hands and, if leasehold property is involved, may not require the landlord's consent unless there is an owner change of control provision in the relevant lease (see question 22). There may be a change of control covenant in the target financing/facility agreement that will need renegotiation or the financing repaid on completion of the combination. By acquiring ownership of the target company, the buyer inherits all the liabilities in the target (eg, for debt and tax and the target's commercial and management contracts). Stamp duty is lower (0.5 per cent on the consideration for the shares) but the buyer inherits the capital gains tax base cost in the target for the real estate asset that may be lower than the purchase price for the shares or the current market value of the real estate asset (see question 11).

A business or asset acquisition allows the buyer to limit the liabilities it assumes to those specifically set out in the contract but each asset will need to be transferred individually and may require third-party consents (eg, the landlord's in respect of leasehold property).

2 Describe the process by which real-estate-related business combinations are typically initiated, negotiated and completed.

Real-estate-related business combinations primarily comprising investment real estate assets are generally initiated in the same way as major real estate sales through property agents. Those for operating real estate assets (eg, hotels, care homes and retail) are usually initiated by marketing through agencies specialising in the relevant asset class. Non-binding heads of terms would be the start of any such deal. There would follow a due diligence stage with a full property title investigation carried out (although sometimes certificates of title from lawyers will be accepted) as well as financial, tax and legal due diligence on the target vehicle.

Negotiation of the deal terms of the contract will generally be carried out by the corporate legal teams with input from tax and property lawyers into the warranties and indemnities contained in the contract. Contracts for real-estate-related business combinations are generally exchanged and completed simultaneously unless a consent is required (eg, from a landlord or regulator).

If the contract is conditional, the concept of a deposit on exchange can often be found. This is a crossover from the pure property contract structure. Care must be taken with the deposit provisions as, unless the standard commercial property conditions (SCPCs) (see more in answer to question 3) are incorporated into the corporate contract, express provisions will need to be spelt out on termination and forfeiture of deposit for non-completion.

If a private equity fund is a major seller, warranty and indemnity insurance may be obtained in respect of the seller's liabilities under the contract. A third firm of lawyers or an in-house legal team will be involved reviewing the contract on behalf of the broker or insurer.

3 What are some of the primary laws and regulations governing or implicated in real-estate-related business combinations? Are commercial, residential or agricultural real estate assets subject to specific regulation that would be material in a typical transaction?

The private purchase of shares of a real-estate-related business, or its business and assets, is governed by the same laws and regulations as other business combinations.

Real-estate-related business combinations, where the target is a public company with its registered office or central place of management and control in the UK, the Channel Islands or the Isle of Man, must comply with the UK City Code on Takeovers and Mergers (Takeover Code). In limited circumstances the Takeover Code also applies to a private company, for instance where such company's shares were admitted to trading in the UK, the Channel Islands or the Isle of Man at any time during the previous 10 years.

The Takeover Code contains rules governing all aspects of a takeover, including the announcement of the public offer for shares in the target company, the offer document and timetable, and the target company's response.

Where the target of a takeover offer is a company with significant real estate assets, the Takeover Code provides for specific rules governing the valuation of land, buildings, plant and equipment (Rule 29). Such an asset valuation would typically be prepared where the target company believes that an offer undervalues its assets and will be required for any offer document and also any shareholders' approval circular. Asset valuations must (i) comply with the Takeover Code's detailed requirements for the basis of the valuation (normally market value) and disclosure of potential tax liabilities that would arise if the assets were to be sold at the valuation figure, and (ii) be supported by the opinion of a named independent valuer.

In addition, the Prospectus Rules contained in the UKLA Sourcebook of Rules and Guidance (UKLA Sourcebook) made by the Financial Conduct Authority (FCA) as the UK Listing Authority (UKLA) may apply. There is an exemption from the requirement to produce a prospectus for public offers or admission to trading of securities in connection with a takeover by means of an exchange offer, provided a document is available containing information which is regarded by the FCA as being equivalent to that of a prospectus.

The Listing Rules of the UKLA and the AIM Rules will apply to certain major acquisitions and disposals by public companies whose shares are listed or traded on these markets too.

The collective investment provisions of the UK Financial Services and Markets Act 2000 (FSMA) will apply to certain corporate structures

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that hold real estate assets, for example, unit trusts which themselves will need to be regulated or limited partnerships that are unregulated collective investment schemes involving a pooling of investments and lack of management involvement and that therefore need regulated operators and cannot be marketed to the public. In addition, if the target business is an alternative investment fund (which includes real estate funds and investment trusts), its manager or itself (including the senior managers in this case too) need to be authorised or registered by the FCA to carry out such activities (see also the answer to question 33). Certain prescribed information must be given to the FCA to obtain approval and any material changes to this information must be notified to the FCA in advance of implementing the changes (eg, information about the controllers of the manager).

Where there is a business asset purchase, ownership of the property is transferred at the Land Registry and so a separate transfer of the property must take place. It is usual for the terms of the sale and purchase agreement and the SCPCs to govern the terms of the transfer. These are an industry standard set of conditions that are usually incorporated into the sale and purchase agreement and that give uniformity across the board and avoid the need for standard provisions to be negotiated in every transaction.

The transfer of a leasehold property will be subject to additional legislation. Consent is likely to be required from the landlord of the property to transfer the lease to the buyer. Landlord and tenant legislation governs this process and what must happen in the event the landlord refuses to grant consent to the transfer. Usually consent may not be unreasonably withheld or delayed, but conditions may be imposed including a requirement for an 'authorised guarantee agreement' being a guarantee by the transferor of the obligations of the transferee as tenant under the lease until the transferee transfers the lease to a subsequent buyer.

Where the business combination involves residential properties, the properties would be occupied by residential tenants who have protected rights of occupation. The new owner could not simply decide to evict all of the tenants because it wants to use the properties for another purpose. The same applies to commercial premises. Under landlord and tenant legislation the tenants may be entitled to the grant of new leases at the end of the existing terms and if the owner wishes to redevelop the property there is a statutory process to follow that can involve the payment of compensation to the occupiers.

Agricultural properties may be subject to additional legislation and consents governing the farming activities taking place at the property and a separate regime that may provide security of tenure to agricultural tenants.

The acquisition of a care home business will require the consent of the Care Quality Commission. It is usual to exchange contracts conditional on obtaining such approval for the new owner.

4 Are there any specific regulations relating to cross-border combinations or foreign investors or acquirers that are material to real-estate-related business combinations and related structures?

There are no specific regulations that relate solely to real-estate-related business combinations, foreign investors or related structures. However the EU Merger Regulation and the UK Companies (Cross-Border Mergers) Regulations 2007, as amended (the Regulations) that implement the EU Cross-Border Mergers Directive (replaced by the EU Directive 2017/1132 from 20 July 2017) can each apply to such combinations. (See question 15 on cross-border transactions of the England & Wales chapter in Getting the Deal Through *Mergers & Acquisitions* 2017.) The Regulations apply to public and private limited liability companies where a UK company is involved in a merger with one or more EEA companies.

A cross-border merger will be subject to the Takeover Code, including the real-estate-relevant rules (see question 3) where the target is a company subject to the Takeover Code. The Code does not differentiate between offers by domestic or foreign investors; there are no restrictions on foreign ownership or occupation of real estate.

5 What territory's law typically governs the definitive agreements in the context of real-estate-related business combinations? Which courts typically have subject-matter jurisdiction over a real-estate-related business combination?

Agreements will be governed by English law, even those for overseas companies holding real estate assets in England and Wales. Local counsel will be engaged to opine on local securities laws and completion requirements where an overseas company is the target. If real estate business assets are being acquired in several jurisdictions there may be an English law umbrella agreement that governs the overall transaction with local law agreements in single jurisdictions dealing with local issues (eg, employee consultations and asset transfers). English courts will have jurisdiction in respect of the English law agreements and English transfers of securities and real estate assets. Transfers of foreign securities formalities will apply in respect of the transfer of foreign shares (eg, the shares in a BVI company owning property in England and Wales).

6 What information must be publicly disclosed in a public-company real-estate-related business combination?

If the acquisition is a class one acquisition or disposal for a company (not in the ordinary course of business, ie, not the sale of a current asset) that has a premium listing on the Official List of the UKLA, or a reverse takeover or fundamental change of business under the AIM Rules, shareholders' approval will be required due to the size of the transaction. An AIM company undergoing a reverse takeover will need to publish a new admission document in accordance with the AIM Rules and a premium listed company undertaking a class one acquisition or disposal will need to publish a circular to shareholders and each at the same time would need to call a general meeting of shareholders for their approval. In the event that an acquisition or disposal by a listed company of real estate or of a property company that is not listed requires a shareholder vote, the listed company must include in the circular to its shareholders a property valuation report. Such a report is generally required where a listed company makes significant reference to the value of a property in a circular. If the buyer offers shares as consideration for the acquisition or to finance it, there may also need to be published a prospectus or listing particulars with further information on the enlarged group under the relevant listing or AIM Rules including details of major litigation and a working capital statement (but see question 3 regarding exemption if equivalent information is published).

The information that must be publicly disclosed in the context of a public company real-estate-related business combination for a company whose securities are listed on the Official List is set out in the UKLA Sourcebook, which includes the Listing Rules, the Prospectus Rules and the Disclosure Guidance and Transparency Rules sourcebook (the DTRs), and for public companies' whose securities are traded on AIM in the AIM Rules.

Listed companies need to comply with the DTRs and provide public disclosures to the market. Those with a premium listing will also need to disclose details of class transactions under the Listing Rules to the market.

(See question 3 in relation to Prospectus Rules and exchange offers.)

AIM Rule 11 requires an AIM traded company to announce new developments not publicly known, which, if made public, would be likely to lead to a significant movement in the price of its shares, and prescribed details of any substantial transactions it enters into. AIM companies like fully listed companies must also comply with the new Market Abuse Regulation that is directly applicable in England and Wales in respect of the disclosure of inside information.

For a public company real-estate-related business combination involving a takeover offer for shares in the public company, the Takeover Code will require an offer document (or possibly a scheme of arrangement that complies with the Takeover Code but also needs to be in a form approved by the English High Court) and this must contain inter alia under Rule 24.3(vi) the effect of acceptance of the offer for the target on the offeror's earnings, assets and liabilities and summary details of non-ordinary course material contracts that include details of prices paid for past real-estate-related acquisitions or portfolios and major facility and financing agreements under rule 24.4(vii). For real-estate-related targets, this will usually require details of the relevant real estate assets and current market valuations of those to be acquired in the target and owned by the offeror group. This would be the case for

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a public to private combination too as an offer document or scheme of arrangement would still need to be published in respect of such combination complying with the same rules of the Takeover Code.

7 Give an overview of the material duties, if any, of the directors and officers of a company towards company stakeholders in connection with a real-estate-related business combination. Do controlling shareholders have any similar duties?

(See question 7 on duties of directors and controlling shareholders in the England & Wales chapter of Getting the Deal Through: *Mergers & Acquisitions* 2017 for the relevant duties under English law.)

If the seller or buyer or target is an English company these will apply to the directors of the relevant English company regardless of the underlying law governing the contract or asset transfer. If the seller, buyer or target is not an English company, then the jurisdiction of its incorporation or formation will dictate what the duties of the directors, officers and controlling shareholders of the relevant entity are.

8 What rights do shareholders have in a public-company real-estate-related business combinations? How do acquirers address and structure around the risks associated with shareholder dissent in the context of real-estate-related business combinations?

When a public company, subject to the Takeover Code, is the subject of an offer or scheme of arrangement (this will include public to private transactions), shareholders' rights in the target are protected and reinforced by the Takeover Code. Generally a public offer will require a 50 per cent plus acceptance of the offer by target shareholders. A shareholder cannot be forced to sell unless the offeror acquires 90 per cent of the shares subject to the offer. Under a scheme of arrangement (which also needs approval by the English High Court) a majority in number representing 75 per cent in value of shareholders present and voting at the meeting is required for approval. A shareholder does have a right to object to a buy out or squeeze out of his or her shares under section 986 of the Companies Act 2016 in connection with an offer; the court can then order different terms of the acquisition. A shareholder can also object to a scheme under section 900 of the Companies Act 2006.

As discussed in question 6, certain acquisitions or disposals by a listed or traded company will require shareholders' approval under the Listing Rules or AIM Rules.

Under the Takeover Code the target public company must appoint a rule 3 adviser to advise the board (and the board must make this advice available to the target's shareholders) on the terms of the offer to the target's shareholders that will include the consideration offered. An offeror will try to ensure target board approval for the proposed combination and non-binding undertakings from major shareholders to accept the offer or approve the scheme of arrangement in advance of launching an offer. A public to private transaction will usually have some element of management support to be successful too.

9 Which kinds of termination fees are permissible, and what is their magnitude?

A listed or traded public company real-estate-related business combination will generally be an acquisition or disposal governed by the Listing Rules or AIM Rules, or an offer or scheme of arrangement in respect of the shares in the target plc governed by the Takeover Code. In addition, the financial assistance provisions of the Companies Act 2006 will apply to English public companies prohibiting certain types of financial assistance given by a public company in connection with the acquisition of shares in it. The Takeover Code specifically provides that termination and break fees may be entered into by the target company in limited circumstances if they do not exceed an amount equal to 1 per cent of the value of the target at the offer price. The Listing Rules provide that termination and break fees that exceed 1 per cent of the value of the target by the offer price constitute a class 1 transaction and require shareholder approval. The AIM Rules are silent on this issue though.

If a public company is subject to an offer, or its board thinks it is imminently likely to be, Rule 21 of the Takeover Code (Frustrating Actions) applies. This provides that it cannot, for example, issue shares or options or sell or acquire material assets or enter into non-ordinary course contracts without shareholder approval. 'Poison pills' are not permissible under English law as a consequence.

The board of directors of any English company (public or private), before agreeing to a termination fee or break fee or carrying out a 'frustrating action', must be sure that such action is in the interests of its shareholders in that it will promote the success of the company for its shareholders as a whole so that they are not in breach of their fiduciary duties to the company. Directors must also under English law only use the powers they are given for a proper purpose. For example, they cannot approve the issue of more shares in the company if the motive for such issue is to prevent the takeover of the company.

Real-estate-related business combinations, whether structured as a share purchase or business acquisition, can be conditional and in such circumstances a deposit will be payable. This can be forfeited by the seller if the buyer fails to complete after a certain period after the contractual completion date.

10 How much advance notice must a public target give its shareholders in connection with approving a real-estate-related business combination, and what factors inform this analysis? How is shareholder approval typically sought in this context?

If the real-estate-related business combination is an acquisition or disposal requiring shareholders' approval (eg, a class 1 circular under the Listing Rules or reverse takeover under the AIM Rules) a shareholders' meeting will be required and a circular with notice of meeting will need to be sent to shareholders, generally giving 14 working days' clear notice of the meeting for premium listed public companies. If the plc has not allowed voting by electronic means 21 clear days' notice will be required. The contents of a class 1 circular need to be approved in advance by the UKLA and, for an AIM reverse takeover, an admission document will need to be issued too.

If the real-estate-related business combination is an offer for the shares in a public company, the timetable is governed by the Takeover Code. Following the announcement of the offer, the offeror (and offeree if a recommended offer) must send an offer document to the target's shareholders within 28 days of the announcement of a firm intention to make an offer. There is usually an initial period of 21 days to accept the offer and the offer must remain open for 14 days after it is declared unconditional as to acceptances. A scheme of arrangement timetable will be set by the English High Court as well as the Takeover Code timetable regarding offers applying to it. This can be a two-month process. A majority in number representing 75 per cent of shareholders represented at the shareholders' meeting must approve the scheme.

11 What are some of the typical tax issues involved in real-estate-related business combinations and to what extent do these typically drive structuring considerations? Are there certain considerations that stem from the tax status of a target?

The nature of tax issues involved in real-estate-related business combinations varies depending on whether the acquisition is of a vehicle or the underlying assets of a real estate business (ie, a business acquisition).

The tax issues in play also concern the jurisdiction of residence for UK tax purposes of the target vehicle itself (for a vehicle acquisition) or the buyer (in relation to a business acquisition).

Acquisition of target vehicle

Form of acquisition and issues

The main commercial issue in relation to tax is that the shares are purchased by the buyer and it will purchase the target as an entity. Economically, therefore, the value of the shares purchased will be linked to the net asset value of the target. Accordingly, any unexpected or unpaid tax liabilities will affect the value of the shares purchased.

In addition, by purchasing the shares, the buyer's base cost for UK capital gains purposes will be in that asset rather than the underlying real estate assets.

Generally speaking, a UK-incorporated company will be resident in the UK for UK tax purposes and it will accordingly be liable to pay UK corporation tax on all profits and gains (wherever they arise). This general position may be modified, for example, by the availability or application of a double taxation convention between the United Kingdom and another country (eg, the United States).

Unless a non-UK incorporated company is centrally managed and controlled from the UK it will not (generally speaking) be liable to UK corporation tax unless it carries on a trade in the UK through a

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permanent establishment (PE) in the UK or, if legislation in the UK subjects the profits of such a trade to tax in the UK, irrespective of the existence of a PE.

A non-UK incorporated company will not be resident in the UK for tax purposes unless its central management and control is exercised from the UK. This broadly comprises the highest level of control of the business of a company – notably, at the level where fundamental decisions of policy, strategy and management relating to matters as diverse as the overall direction of the company, financing, strategic joint-venture arrangements, and so on, are taken. This distinguishes the place where such decisions are taken from the place where the actual day-to-day business is carried on or the place where strategic decisions taken by the board are implemented.

It is usually the directors of a company who are entitled to exercise the central management and control of a company, although for the purposes of UK law this will be ultimately a question of fact as to whether the actual management and control is always exercised by the board of directors.

It is possible for the control of a board of directors to be usurped, for example, by an individual or individuals based in the UK (who may or may not be directors), in which case the powers of the board could be usurped and control of the company in question would in such circumstances be exercised from the UK. This would mean that such a company is likely to be tax resident in the UK in the same way as a company incorporated in the UK.

Some caution is required, however, as it is possible for the board of directors of a company to meet and ostensibly take all decisions outside the UK, but in circumstances where in reality the board does not exercise any real independence and merely endorses decisions actually taken in the UK. Recent case law in the UK has indicated that a non-UK established board of directors will need to have the requisite knowledge and skills to enable them to exercise independence and take decisions independent of any external influence.

Accordingly, when a non-UK incorporated target company is being acquired, a critical part of the due diligence process will be to consider its place of central management and control. This is important in order to determine the target's historic exposure to UK tax, but also to guard against tax rules such as those targeting situations where non-UK incorporated companies are centrally managed and controlled from the UK and then become centrally managed and controlled from outside the UK; in these circumstances such a company is deemed to dispose of its capital assets at market value, which could give rise to a capital gain.

One example of how this could arise is if the buyer acquires a non-UK incorporated target where little attention has been paid to where strategic decisions etc are taken. A buyer could inadvertently trigger a charge to UK tax by ensuring that post-acquisition strategic decisions etc are taken outside the UK.

The purchase of shares in a UK-incorporated company will be subject to UK stamp duty or stamp duty reserve tax (SDRT), which will be chargeable at 0.5 per cent on the amount or value of the consideration for the purchase of the shares. This may be less than the value of the underlying real estate asset as the vehicle owning it may be leveraged with bank debt and shareholder loans too. The contract will then include a collateral obligation on the buyer to procure the repayment of this debt by the target at the same time as paying for the shares in the vehicle owning the property.

The purchase of shares in a non-UK incorporated company may be chargeable to UK stamp duty or SDRT, for example, if the instrument of transfer is executed in the UK or if it otherwise relates to something done or to be done in the UK. This would be an issue, for example, if the non-UK incorporated company kept a share register in the UK, in which case SDRT would also be chargeable.

In practice, stamp duty and SDRT should not both be chargeable on the same transaction. In general terms, stamp duty will apply to certificated shares and SDRT to uncertificated shares.

UK limited liability partnerships (LLPs) carrying on a business are transparent in the UK for tax purposes. Accordingly, the acquisition of an interest in such an entity is akin to the purchase of business assets from the existing members (see below). Members of a UK LLP that carry on a trade will themselves be treated as carrying on a trade in the UK and will, accordingly, have a liability to tax in the UK going forward. This applies equally to non-UK resident members.

In addition, the acquisition of a membership interest in an LLP can in certain circumstances give rise to a stamp duty land tax liability for the buyer (see below).

Considerations stemming from tax status of target

As mentioned above, the purchase of shares in a company means that its tax history is effectively inherited by the buyer and the value of the shares acquired will bear the risk of any historical non-compliance by the target company with all UK tax legislation.

As an entity in its own right, a company will (generally) not dispose of any of its assets when its shares are acquired. Accordingly, the historic base cost of capital assets owned by such company will not be affected by the acquisition of the shares, this position will be inherited by a buyer of the shares. It follows that if a subsequent disposal of a capital asset by the target company results in a capital gain arising it will not be possible to reduce that gain by deducting the price paid by the buyer for the shares. In other words, the buyer's base cost will be in the shares and not any underlying real estate asset held by the target as capital.

UK tax legislation contains many anti-avoidance rules targeted towards the ownership of real estate. Such rules can recharacterise or redefine the structure of transactions in certain circumstances whereas some can operate to convert the proceeds from a transaction from capital to income – a common scenario comprises overage or profit share arrangements.

If the tax risks that exist as a result of the buyer acquiring the shares in a target company are high or very uncertain, the structure of the transaction can change with the buyer instead choosing to purchase the assets as opposed to the shares.

Business purchase

A purchase of the assets of a business, including UK real estate, will give rise to tax consequences for a buyer. The obvious tax charge is a liability to stamp duty land tax (SDLT), which is charged by reference to the consideration given by the buyer for the real estate element. The rules themselves are complex (particularly in relation to partnerships and LLPs and non-cash consideration such as debt), and SDLT is payable by reference to a banding system. Currently, the top rate of SDLT in relation to residential property is 15 per cent and for commercial property it is 5 per cent. Relief from payment of SDLT may be available for group company transfers.

Subject to the next paragraph, VAT may also be payable in relation to the purchase of commercial real estate at 20 per cent, but it may be possible for the buyer to effectively claim this back from HMRC. If VAT is payable (at 20 per cent), SDLT will be due on the amount of VAT too.

If the buyer is buying a business whose assets include UK real estate or if it comprises a rental business (ie, UK real estate is purchased with the benefit of a lease), then the purchase may comprise the transfer of a going concern for VAT purposes (TOGC). Conditions apply for a transaction to comprise a TOGC, but if a transaction comprises a TOGC, VAT will not be payable by the buyer (and as a consequence any SDLT will reduce).

In most cases concerning the acquisition of commercial real estate, it is likely that a buyer will need to become registered for VAT, if it is not already.

Generally speaking, when a buyer acquires assets as opposed to shares in a company it will not inherit any tax risk of the underlying business. One exception concerns VAT. It is possible for a buyer to be obliged to pay VAT to HMRC after it has purchased the business that relates to a period that commenced prior to completion (ie, it will be an additional cost to the buyer).

Another exception concerns SDLT. If, as part of the purchase, the seller assigns a lease to the buyer, the buyer will inherit the SDLT compliance obligations in relation to the lease.

If the business being purchased is a trading business and the buyer is not incorporated or tax resident in the UK it is likely that the business being purchased will amount to a PE of the buyer in the UK, which will give rise to a taxable presence of the buyer in the UK (to the extent it does not have one already).

If the business being purchased owns UK real estate with the benefit of rental income and the buyer is not incorporated or tax resident in the UK, UK income tax will be due in relation to the rental income. This will either be paid to HMRC by way of deduction from the rent paid by the UK tenant or agent unless the buyer obtains the agreement of

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HMRC for the rent to be paid without deduction and for the buyer to pay the income tax at a later date.

There could also be capital allowances implications that must be addressed by the seller prior to the disposal in order for the buyer to take any future benefit of the allowances.

12 What measures are normally taken to mitigate typical tax risks in a real-estate-related business combination? How important are tax issues in evaluating structuring alternatives in the context of a real-estate-related business combination?

As discussed above, the acquisition of shares in a company effectively means that the buyer inherits the company's tax compliance history. It is critical, therefore, for a buyer to undertake tax and financial due diligence to ensure it is fully apprised of the risks involved.

In a listed company acquisition, a buyer will not be able to get contractual indemnities for such risks from the sellers so any identified tax liability will need to be factored into the offer price.

In a private company acquisition, a buyer should obtain two main forms of protection in the purchase contract: tax warranties and a tax indemnity.

Tax warranties can be very extensive (ie, 15 pages long plus) if the nature of the business and its compliance history merit them. While comprising a series of contractual promises made to the buyer, the warranties also force the seller to disclose detailed information to the buyer and, accordingly, they serve an information seeking purpose in addition to providing a contractual remedy to the buyer in the event of a breach of warranty.

A tax indemnity from the seller in favour of the buyer is the main form of protection for the buyer. Its objective is to ensure that the seller is on risk for all pre-completion tax liabilities of the target. If a liability of the seller arises under the indemnity, the buyer can make a claim against the seller as if it were a debt due to it – non-payment of which means the buyer should be able to obtain summary judgment in order to enforce the debt. The seller will provide the tax indemnity on the basis that a number of exclusions and limitations are available to it.

If during the course of negotiation it becomes apparent that purchasing the shares in a target company would involve the buyer assuming tax risk, it may be possible to deal with the risk by an adjustment to the purchase price (either by way of a completion accounts adjustment or by reducing the purchase price). If the risk is known, but not quantifiable, the buyer may be content to make a claim under the tax indemnity following completion. However, if the purchase of the shares in the target company would mean the buyer inheriting a level of tax risk that is not commercially palatable in the context of the transaction as a whole, it may prefer to purchase the business and assets. In relation to UK real-estate-business combinations this will mean the buyer paying stamp duty land tax as opposed to stamp duty (at much higher rates).

13 What form of acquisition vehicle is typically used in connection with a real-estate-related business combination, and does the form vary depending on structuring alternatives or structure of the target company?

Acquisition vehicles for English investment real-estate-business combinations are often structured as offshore limited liability holding companies and SPV subsidiaries for each asset with the ongoing property manager operating the day-to-day running of the properties in England and strategic decisions made offshore. The acquiring vehicle for real estate trading business combinations will generally be an on-shore limited liability company. A limited partnership (pass through for tax purposes) may be required as the buying entity for a real estate fund.

Some acquisition vehicles may be limited liability company structures (SPVs for a single property) but set up as joint ventures between the financier and a developer or property manager. A new acquisition vehicle, whether for a share or business acquisition, will limit the buyer's liabilities to the acquisition vehicle (unless a parent guarantee is required) and will also enable liabilities for debt funding and the security net for such funding to be limited to the new structure including possibly a pledge over the shares in the new acquisition vehicle and the target. A business asset combination where only selected assets and liabilities are assumed will limit a buyer's exposure further, especially as under such a combination the tax liabilities of the target business will not generally be acquired and underwritten by the buyer going forward.

14 What issues typically face boards of real-estate-related public companies considering a take-private transaction? Do these considerations vary according to the structure of the target?

In a public company take-private transaction the main issue facing the board of directors of the public target company will be to ensure there are sufficient independent directors not conflicted by the transaction to be able to make an informed independent decision about it, and that the board gets independent financial and valuation advice. This is because a public take-private transaction generally involves the executive management team making an offer backed by external equity and third-party debt. When such an approach is first made to the board a committee of the board of independent directors will need to be formed with delegated authority to make all decisions in relation to the offer. A rule 3 financial adviser will also need to be appointed under the Takeover Code to advise the board, and an independent valuation of the target's real estate assets should be obtained that will not only form the basis for the response to the approach or offer but will also be required for any resulting offer or defence document.

15 How long do going-private transactions typically take in the context of a public real-estate-related business combination? What are the major milestones in this process? What factors could expedite or extend the process?

The time period for going-private transactions in respect of public real-estate-related business combinations will generally be slightly longer than a simple offer for a public company as the external equity and debt provider will want the offeror to obtain at least over 75 per cent ownership of the equity shares in the target public company, if not 100 per cent. This will enable a public company with a premium listing to be delisted without a further shareholder approval (generally 75 per cent and a majority of votes of independent shareholders if there is a controlling shareholder), converted to a private limited company and for a full security package to be put in place over the target group's real estate assets to secure the acquirer's debt. A public company cannot give security or guarantees in connection with the acquisition of its shares. A scheme of arrangement with the lower shareholder approval threshold of a majority in number representing 75 per cent of shareholders present and voting in favour at the relevant approval meeting may in certain circumstances, despite the longer court timetable, expedite this process. If the independent board of the public target rejects the offer so it becomes hostile or some shareholders object to the squeeze out and purchase of their remaining shares once 90 per cent acceptances of the offer are obtained by the acquirer, the process can be even further extended.

16 Are non-binding preliminary agreements before the execution of a definitive agreement typical in real-estate-related business combinations, and does this depend on the ownership structure of the target? Can such non-binding agreements be judicially enforced?

In private real-estate-related business combinations non-binding heads of terms are generally very common and will also include binding terms relating to exclusivity and sometimes indemnities or provision for payment of costs for breach of exclusivity. There may even be an initial non-refundable deposit payable to the seller for exclusivity. The remainder of the non-binding terms are not judicially enforceable as under English law an agreement to agree is not capable of being an enforceable contract and there is no general concept of a duty to negotiate in good faith. In public real-estate-related business combinations that involve an offer or scheme subject to the Takeover Code, these will generally only take the form of break fees or inducement fees or other offer-related arrangements in the limited circumstances provided by the Takeover Code (rule 21.2). A listed PLC would also need to make an announcement in respect of any major transactions.

17 Describe some of the provisions contained in a purchase agreement that are specific to real-estate-related business combinations? Describe any standard provisions that are contained in such agreements.

Warranties are not usually given in transactions that relate solely to the sale and purchase of real estate. As stated below, the principle of caveat emptor (let the buyer beware) applies, meaning that the due diligence carried out by, or for, the buyer is of crucial importance. Incorrect

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information given by or on behalf of a seller may give rise to an action for rescission or damages for misrepresentation, but not a contractual claim for damages for breach of warranty. For this reason, in connection with business combinations, extensive warranties are more often seen in share purchase rather than asset purchase transactions.

A buyer will argue that it should receive a full set of warranties in respect of the real estate assets covering for example, title and condition; however, even in a share purchase, a seller will want to give as few property warranties as possible and will require the buyer to rely on its own due diligence.

Warranties for planning and environmental matters and relating to the physical condition of the property are also highly unlikely to ever be given by a seller. A buyer will ordinarily rely on its own surveys, searches and enquiries and inspection of the property.

A representation that a specified property is the only one occupied for the purposes of a business are often sought and given, since this is not something that is easily capable of independent verification as part of the due diligence process.

In most real-estate-related business combinations involving the purchase of a company, the target will have some form of debt and security over its assets that will need to be repaid and released on completion. Generally, the buyer will procure the release of such debt on completion and that will reduce the headline purchase price for the target shares. The consideration may also be subject to a net asset adjustment based on completion accounts. Such adjustments to the purchase price replicate the accruals you see in a property contract, eg, rental receipts and service charges are apportioned before and after completion. Where the real estate asset has development potential, 'overage' may be payable by the buyer on successful development. Any such overage should be added to the purchase price and payable by the buyer not the target property owning vehicle.

18 Are there any limitations on a buyer's ability to gradually acquire an interest in a public target in the context of a real-estate-related business combination? Are these limitations typically built into organisational documents or inherent in applicable state or regulatory related regimes?

The ability of a buyer to acquire an interest in a public company target in the context of a real-estate-related business contribution is again governed by the Takeover Code and DTR5 on notification of major shareholdings. Under DTR5, a person who holds voting interests in a UK public listed company or AIM traded public company has an obligation to notify the issuer of the percentage of voting rights held if the percentage held as a shareholder or through holdings of financial instruments reaches, exceeds or falls below 3 per cent or any whole percentage figure above 3 per cent. There are also obligations on non-UK public listed companies when a 5 per cent threshold and 5 percentage points incremental thresholds of such interests are achieved.

Rule 8 of the Takeover Code (Stakebuilding) requires notification of positions and dealings in securities of a target in the context of an offer for a public company subject to the Takeover Code once an offer period has commenced. This will extend to those in the bidder's as well as the target's securities if the offer involves an offer of securities in the bidder too. Once a person acquires an interest in shares that carry 30 per cent or more of the voting rights of a target or a person holding between 30 and 50 per cent of such rights acquires more such rights, such person has an obligation under rule 9 of the Takeover Code to extend an equivalent offer to the holders of all other such rights in the target. Section 793 of the Companies Act 2006 empowers an English public company to request (and enforce such request by a court order suspending rights attached to the relevant securities) disclosure of interests in the company's voting securities too. A target PLC may use this to ascertain changes in ownership of its voting securities at such a time or generally.

19 Describe some of the key issues that typically arise between a seller and a buyer when negotiating the purchase agreement, with an emphasis on building in certainty of closing? How are these issues typically resolved?

Unless there is a requirement for consent from a landlord or regulator or from shareholders of a party to the contract, most real-estate-related business contributions will be exchanged and completed simultaneously. The majority will not be subject to a financing condition. If a condition is required the seller will likely require a deposit and would have similar rights to terminate and forfeit the deposit for non-performance by the buyer as in a property sale. The buyer will try to get some pre-exchange feel for the satisfaction of conditions, for example, landlord's approval in principle and undertakings from majority shareholders to vote in favour of any transaction requiring the target's shareholders' approval. The buyer will also be concerned about any changes to the business or real estate assets between exchange and completion and where the risk lies between the parties. The seller will want to update disclosures and the buyer will want the right to walk away if there is any material adverse change in, for example, the financial position of the target business, the condition of the property and litigation commenced during this period. The buyer in particular will need this if its financing is conditional on no such material changes to the target business and its assets and liabilities.

If consent is not obtained from the landlord in respect of certain assets, the buyer may go ahead with the rest of the transaction without those assets. In some scenarios a buyer may go ahead without consent to assignment of a particular real estate asset with or without some kind of informal occupation right or licence until the consent has been obtained and the real estate interest can be formally assigned.

20 Who typically bears responsibility for environmental remediation following the closing of a real-estate-related business combination? What contractual provisions regarding environmental liability do parties usually agree?

Where there is historic contamination, there are a number of ways in which the parties can agree to deal with this. Where costs are not factored into the transaction at the outset, it is not uncommon for the purchase price to be adjusted to cover any remediation liabilities and for environmental risks to be expressly allocated to the buyer. If the agreement is silent on environmental liability this means that both the seller and the buyer could be liable under Part 2A of the UK Environmental Protection Act 1990. Even after the sale of a property, the seller could remain liable under this Act as a 'Class A' person who caused or knowingly permitted the contamination. If the enforcing authority cannot find a Class A person, it will serve a remediation notice on a Class B person that would include the current owner or occupier of the land. The parties may agree to allocate liability for historic contamination between them. Subject to such agreement being complied with, the enforcing authorities will usually not intervene.

Warranties and indemnities relating to the environmental condition of the property are not usually given (caveat emptor; see question 17) and a buyer will usually wish to carry out its own due diligence on environmental matters unless a recent report has been commissioned from an environmental consultant upon which the buyer can obtain reliance or a deed of collateral warranty from the consultant is offered by the seller. Moreover, a sale and purchase agreement will often provide that the buyer has been given full access to the property and the ability to carry out whatever tests, enquiries and surveys a prudent buyer would carry out. The buyer will be deemed to buy with full knowledge of everything that such tests, enquiries and surveys would have revealed whether or not they have been carried out and, so far as the enforcement authorities are concerned, such a provision means that a property is 'sold with knowledge', which, in turn, usually means that the buyer will be the Class B person liable for clean-up costs in the absence of the identification of a Class A person.

An alternative solution is for the buyer to effect environmental impairment liability insurance that would provide coverage in respect of possible remediation costs.

If redevelopment of the property is likely, a buyer will usually want to carry out an intrusive environmental investigation at the property prior to completion and the sale and purchase agreement could be conditional pending satisfactory results of the investigation.

Whether the business combination takes place as an asset purchase or a share purchase, the liability for future contamination primarily rests with the polluter.

21 What other liability issues are typically major points of negotiation in the context of a real-estate-related business combination?

Liability issues affecting a property, other than in respect of contamination issues as referred to above, generally relate to the condition of the

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property, or liabilities under town and country planning legislation or arising from prior transactions affecting the property.

If the property is leasehold, disrepair may be a breach of covenant under the terms of the lease, such that the lease is technically subject to forfeiture by the landlord. Inspection by an appropriately qualified expert will establish the condition of the property.

So far as town and country planning issues are concerned, there may be a breach of a condition in a planning permission or failure to comply with an obligation under a planning agreement affecting the property. Carrying out the relevant searches, making appropriate enquiries of the seller and inspection by an appropriately qualified expert will reveal matters such as – depending upon the use of the property – a breach of health and safety legislation (at least so far as the enforcing authority is aware) and the content of conditions in relevant planning permissions and obligations under planning agreements. Based upon the result of such searches, enquiries and inspections, appropriate protections can be built into the sale and purchase agreement (such as, by way of example, a reduction in the price or the holding of a retention from the price to cover any liabilities that crystallise within a set period).

A further possible liability may arise from a prior transaction, such as an obligation to pay a deferred part of the price or an obligation to pay 'overage' to a previous seller. Again, proper due diligence will establish the existence of any such liability so that appropriate protections can be built into the sale and purchase agreement.

For a business asset combination which involves the effective acquisition of real estate assets run as a business, liabilities may arise in respect of the transfer of staff (TUPE liability) and under supply contracts. A share acquisition may also involve the termination of a property management agreement and resultant TUPE liability in respect of employees engaged in the property management business in respect of the target real estate assets transferring to the target on termination. A properly negotiated sale and purchase agreement will deal with appropriate allocation and mitigation of the responsibility of such liabilities.

22 In the context of a real-estate-related business combination, what are the typical representations and covenants made by a seller regarding existing and new leases?

Where the target business occupies leasehold property for the purpose of business, the seller will disclose a copy of the existing lease or leases and the related supplemental documentation such as deeds of variation, landlord consent to carry out alteration works and to the grant of any underleases, security documents such as deeds of guarantee and rent deposit deeds and any notices and current disputes relating to the properties. In multi-let buildings where there are a number of occupational tenants and the seller or target is one of those, the buyer will wish to see the landlord's service charge and rent payment and arrears schedules. On a practical level the position relating to payment of rent and service charge by the seller and the existence of any arrears will need to be established. A buyer will require that the seller is up to date with its payments. The agreement for sale will apportion responsibility for any service charge sums that are paid on account or invoiced after completion for the period prior to completion.

In a business or asset purchase combination, it is likely that landlord consent will be required to transfer each of the leasehold properties. Wording must be included in the agreement governing this process, the effort the seller is required to make in order to obtain the consent and what will happen if consent cannot be obtained. It is usual for an agreement to be conditional upon obtaining consent in relation to each of the properties so that the property in question falls out of the deal if consent to the transfer cannot be obtained.

A seller is unlikely to give any warranties in relation to the leases other than to confirm that factual details set out in a schedule are correct. A properly advised seller will resist a covenant that it is in material compliance with the terms of the lease so that it will be critical for the buyer to establish by due diligence and expert survey advice that the tenant is in compliance with the lease terms. The most that can usually be expected is a representation that the seller has received no notice of any breach of any lease from the applicable landlord.

Where a transaction involves the acquisition of a real estate investment business comprising properties that are subject to occupational tenancies (such as multi-let shopping centres, office blocks, business parks or residential apartment blocks), it is likely that the sale and purchase agreement will contain schedules setting out the relevant details of such tenancies (property address, unit number, name of tenant, term commencement date, length of term, current rent and rent review dates, break clauses and so forth). Sometimes the seller will be prepared to warrant the accuracy of such schedules; sometimes the buyer will have to satisfy itself as to the accuracy by the due diligence process. Similarly, it is possible to require a seller in such circumstances to warrant the accuracy of payment histories, arrears schedules, service charge expenditure and so forth where the seller has control of the provision of such information that is not capable of independent verification.

23 Describe the legal due diligence required in the context of a real-estate-related business combination. What specialists are typically involved and at what point in the transaction are the various teams typically brought in?

The principle of caveat emptor (let the buyer beware) places the onus on the buyer to investigate the property and related planning, environmental and construction matters and find out everything it wants to know before becoming contractually bound to buy the property and related assets (or, in the case of a share purchase, the vehicle that owns the property).

Legal property due diligence will start as soon as possible after non-binding terms have been agreed between the seller and the buyer. This will include obtaining replies from the seller to industry standard form enquiries, reviewing the title deeds and documents, and carrying out searches (including enquiries of the local authority and land charges register (this reveals planning and other important information), drainage and water authority, desktop environmental and flooding searches, highways, utilities companies and infrastructure in the vicinity of the property). The seller's property solicitor will need to provide replies to enquiries at the outset of the transaction (usually in an industry standard format), which will be an important part of the buyer's due diligence on the property

A buyer's solicitor should be involved at an early stage so that they can put in place any requisite pre-acquisition searches relating to the property that have not been made available by the seller's solicitors. Obtaining search results from the local authority can take a number of weeks and cause delay so searches should be commissioned as early as possible in the transaction.

Specialists consultants (such as surveyors) will usually be brought into a transaction at the earliest possible stage as part of the due diligence process.

Further legal due diligence will involve specialist legal teams looking at the corporate ownership and equity funding structure, commercial contracts, facility letters and guarantees and related security over the target's assets, employment and pension liabilities, intellectual property rights and obligations in relation to for example retail chains or hotel groups, any litigation matters revealed involving the target vehicle, and data protection issues.

Financial and tax due diligence will be carried out by the buyer's accountants on the target company or business being acquired.

24 How are title, lien, bankruptcy, litigation and tax searches typically conducted? On what levels are these searches typically run? What protection from bad title is available to buyers, and does this depend on the nature of the underlying asset?

The answer to question 23 describes the typical property title and lien searches carried out by property lawyers. In addition, if the real-estate-related business combination is the acquisition of an English limited liability company, searches will be carried out at Companies House in respect of the company's public registered information, for example, whether it is insolvent or not, to check if its filings are up-to-date, and in respect of any charges registered over its assets and undertakings. Further searches can be carried out at the English High Court to ascertain whether any bankruptcy petitions have been filed or litigation started against the target entity. In the case of an asset purchase, Land Registry priority searches will be carried out immediately prior to completion. These establish a six-week priority period within which the transfer deed must be registered.

Tax due diligence will generally involve reviewing the company's tax file and returns with HMRC and its VAT and PAYE returns.

As a seller tends not to give warranty protection for property matters, the buyer may look to other means of protection such as title

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indemnity insurance policies for defects in title, lost or destroyed title deeds and documents, any breaches of restrictive covenants on the title of the properties and specific risks such as lack of planning permission or building regulation consent. Where appropriate, indemnity insurance cover may also be effected in relation to other matters, such as interference with rights of light (in relation to recently constructed property), and sometimes in respect of environmental impairment insurance to cover the possible costs of unexpected clean-up liabilities.

Another approach is not to carry out any searches on the real estate assets and simply to obtain an indemnity insurance policy to cover any matters that would have been revealed by search results had they been carried out. This approach is not popular with lenders but in the event of extremely tight timescales where the seller has not provided search results this may be the only option.

Where there are a large number of real estate assets involved it is also possible to obtain portfolio cover based on a representative sample.

In the event of an outstanding financial liability that is agreed to be the responsibility of the seller, a buyer may wish to retain a part of the purchase price that will only be paid to the seller upon satisfaction of the liability.

On a real-estate-related share combination where there is a private equity seller who is not prepared to give full warranty and indemnity cover, warranty and indemnity liability insurance can often be obtained.

The level and nature of additional protection may depend on the requirements of any lender to the buyer. A lender is likely to want access to the same cover and protection as its borrower (the buyer or target) but may also have specific additional requirements. A lender may also require a legal opinion as to the validity of security and a valuation report on the real estate assets involved.

The opinion or report will be addressed to the lender so it can be relied upon by it. A lender will want to ensure that the benefit of any such opinion or report is assignable.

An opinion or valuation report will always have the backing of professional indemnity insurance (PII). The provider of any opinion or report may seek to negotiate a cap on its liability in accordance with its obligations under the PII policy. This is a matter of commercial negotiation between the parties. It is important for a lender to ensure that the level of PII cover (with or without a cap) is sufficient to cover the lender's predicted loss arising from an error or omission in the opinion or report.

25 What are some of the primary lease issues and other agreements that the legal teams customarily review in the context of a real-estate-related business combination, and does the scope vary with the structure of the transaction?

A real-estate-related business combination will usually involve a review of the following in respect of the real estate assets:

- the Land Registry title to the property (or the documents granting title to the property in the (now comparatively rare) event of unregistered land);
- any lease documents and all ancillary documents;
- documents registered on the title granting rights over property and for benefit of the property, and any restrictive covenants binding title;
- construction-related documents – building contracts, deeds of appointment, collateral warranties, building regulation consents;
- planning documents – planning permissions and planning and infrastructure contribution agreements;
- statutory compliance – risk assessments, fire safety, health and safety;
- charges, security documents and facility agreements;
- public authority and utility searches;
- replies to standard form comprehensive enquiries; and
- service charge accounts.

Where leasehold properties are being acquired, or are held by the target company being acquired, specific issues may arise. In the former case, these can include obtaining landlord consent to an assignment, negotiating an authorised guarantee agreement from the seller (as a matter of law, a landlord can in many circumstances require an outgoing tenant to guarantee the obligations of the incoming tenant for as long as the lease is vested in the incoming tenant); in the latter case, there can be issues relating to the release of the target company's guarantor by landlords of the properties.

In addition commercial agreements supporting the operation of the business in particular property management agreements will be reviewed. In a business asset combination they will need to be novated or assigned individually. A management agreement may be terminated and as a consequence whether in the context of a business asset or share purchase combination the buyer will by operation of TUPE assume the employment liabilities of those employees engaged in management of the real estate asset. Employee contracts and obligations in such circumstances will be reviewed too.

In the circumstances of public real-estate-related business combinations with a large property portfolio or real estate heavy assets, certificates of title may be relied on or reviews only undertaken of the most significant real estate assets. If the offer is hostile, even this level of property investigation will not be possible as the potential buyer will only have access to public sources for real estate asset information.

26 What are the typical remedies for breach of a contract in the context of a real-estate-related business combination, and do they vary with the ownership of target or the structure of the transaction?

Typical remedies would include damages for breach of contract or breach of specific warranties or indemnities. Alternatively, rescission or damages for misrepresentation (which are based on a different measure of damages) may be available for breach of a material representation that induced a party to enter into the contract. In most private sale and purchase contracts it is usual for there to be a de minimis limit on warranty claims, both individually and in the aggregate. If a deposit has been paid and the buyer fails to complete, the seller will generally be able to forfeit the deposit after a period of time has elapsed after the contractual completion date.

27 How does a buyer typically finance real-estate-related business combinations?

It will depend on the size of the transaction, the mix of the underlying assets and the structure of the buyer or target but every transaction involving external financing will require a combination of debt and equity or quasi equity (for example shareholder loans) however configured. Debt in more complex structures will include:

- senior debt secured over the assets of the buyer or target and provided by a single lender or by a club or syndicate. There may be several layers of senior debt all with different pricings and repayment requirements; and
- mezzanine debt provided to an entity further up the ownership structure with security over the shares of the borrower and other entities in the structure or (perhaps) the target.

Shareholder loans or share capital investment will fund the gap between the acquisition price of an asset and the senior and mezzanine debt. Shareholder debt is nearly always unsecured and fully subordinated to the secured loans. Often senior lenders will require a complete prohibition on the repayment of any other debt until repayment in full of secured debt although payment of interest from available cash flow may be allowed. Payments of interest may be permitted from free cash if generated by the asset but only as long as there is no default. A lender (or lenders) with security over shares in the asset owner may seek to take on assignment of the benefit of shareholder debt so that this debt can be written off in an enforcement situation allowing the security holder to sell shares unaffected by significant unsecured creditors.

In most cases involving private real-estate combinations the target debt will be repaid from new debt borrowed by the buyer and onlent to the target for this purpose on completion. Sometimes a lender may agree to the target debt remaining on sale but will treat the target as a new borrower and renegotiate the terms of the facility. For public real-estate-related combinations the buyer will need to raise the debt to finance the acquisition of shares in the target initially and refinance using the target and its assets as security following conversion of the plc target to a private company once the buyer has obtained ownership of over 75 per cent of the voting rights in the target to facilitate this.

28 What are the typical obligations of the seller in the financing?

The primary obligation of the seller in a private real-estate-related combination will be to procure the release of existing security (to the extent it is not being retained) and repayment of all existing outstanding

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Update and trends

Over recent years in major real-estate-business combinations involving private equity funds, warranty and indemnity insurance protection is common rather than full warranty and indemnity cover from a PE seller. Caps on liability will also be lower than the full purchase price. The view being taken that if full property title has been investigated, a buyer will at least acquire this and does not need the benefit of a full consideration cap on seller liability under the contract.

indebtedness if existing property level debt is to be extinguished on completion. This obligation may extend to include intragroup debt.

It will depend on the transaction as to whether debt at the property level stays in place (see question 27). Care should be taken where derivatives products have been entered into (such as interest rate swaps) by the target in support of a senior debt obligation. Because of prohibitive break costs, it may be advantageous to retain the derivative until expiry. Whether this is possible will be a commercial negotiation with the existing (outgoing) lender and the incoming (new) lender.

29 What repayment guarantees do lenders typically require in the context of a real-estate-related business combination? For what purposes are reserves usually required?

Amortisation

Often a senior facility will require structured amortisation (repayment of principal in a fixed amount and on a regular basis) and will combine that with an incentive such as a downwards margin ratchet where certain milestones are met (whether by way of loan repayment or any improvement in the value of the asset).

These milestones are measured by an improvement in the financial covenants contained in the loan documentation.

Cash sweep

Any free cash (available after paying all finance and other liabilities) may be collected and controlled by the lender either to service interest or reduce debt (an informal amortisation) or be used to pay down the outstanding loan on a mandatory basis where financial covenants are in breach.

The control and use of free cash (and whether it should be 'swept') after all finance and other obligations have been paid will be subject to a commercial negotiation and depends on the relative bargaining position of the parties.

Guarantees

The lender may require a guarantee from a sponsor, shareholder or a related third party. The guarantee may be for interest, the secured liabilities or a fixed amount (usually the principal amount of the loan together with interest, fees, costs and expenses). A guarantee may be called upon where the borrower has defaulted.

Compensation payments

Where the borrower or target receives additional payments due to its ownership of an asset, a lender will expect these one-off payments to be applied in reduction of the loan. The loan documentation will usually provide the mechanism for this. Payments of this sort range from surrender premiums for leases, payments for compulsory purchase, recoveries from a seller from a breach of warranty claim, and as a result of compensation paid for an error or omission in an opinion or report.

Sale proceeds

The proceeds of sale from any asset will be used to repay a loan in part or in full (depending on the size of the asset concerned). A borrower should always try to agree that some of the sale proceeds (where it is a partial repayment) are released to it.

30 What covenants do lenders usually insist on in the context of a real-estate-related business combination? Does this vary with the overall financing of the transaction?

The covenants contained in the loan facility fall broadly into the following categories:

- General covenants – ownership of assets, control, operation of the target, the borrower and the entities owning the assets.
- Property covenants – the borrower and the entities owning assets will provide specific covenants relating to the maintenance and operation of those assets.
- Development covenants – specific covenants controlling and regulating the redevelopment of the assets and the drawdown of the loan facility on a stage payment basis as the development progresses.
- Tax and gross-up covenants – covenants confirming the tax status of the borrowers, obliging the borrower to pay additional amounts to the lender where a tax deduction would amount to a shortfall in the amount paid compared to the amount due to the lender.
- Reporting and information covenants – obligations to provide financial and property management information to the lender on a regular (perhaps quarterly) basis together with a confirmation (by way of a compliance certificate) that none of the financial covenants have been breached.
- Financial covenants – which will include:
  - loan to value covenant;
  - interest cover covenant;
  - debt service cover; and
  - weighted average unexpired lease term (WAULT); and in the case of real estate developments:
  - loan to gross development value (GDV); and
  - loan to development costs.

31 What equity financing provisions are common in a going-private real-estate-related transaction? Does it depend on the structure of the buyer?

A new buying vehicle will generally be formed and will be owned initially by the MBO team and then funded by private equity via ordinary or redeemable preference shares, loan notes or stock, and shareholder loans or mezzanine loans ranking behind senior debt. Management will normally be required to roll over the value of some of their shares (if any) in the target into the offeror buying vehicle or invest cash for ordinary shares in the offeror. Even if the management rollover of their target shares' value represents 10 per cent or more of the class in issue, an offer of offeror securities to all shareholders in target will not be required under Rule 11.2 of the Takeover Code. The offer for the public company may be cash, loan notes or shares in the offeror. Shares not admitted to trading will need an independent estimate of their value in the offer document before they can be offered under the Takeover Code to target shareholders. Loan notes avoid this requirement and the complication of having minority former public target shareholders in the buyer. Non-transferrable listed offeror loan notes will not require a prospectus. All shareholders of the same class must be treated equally. Under Rule 24.8, if the offer is for cash or includes an element of cash, the offer document must include confirmation by an appropriate third party (eg, the offeror's bank or financial adviser) that the offeror has sufficient resources available to satisfy full acceptance of the cash offer.

32 Are there particular legal considerations that shape the formation and activities of REITs?

The UK real estate investment trusts (REIT) regime enables qualifying companies and groups of companies to elect to be treated as a REIT or group REIT for accounting periods beginning on or after 1 January 2007, and provides for corporation tax exemption of the income and gains of the REIT's qualifying property rental business. There is a complex regime of rules that has to be complied with relating to the status of the vehicle that is to be a REIT, its ownership and the nature of the property rental business it conducts. However, as to structure, a REIT must be a company whose ordinary shares are either listed or traded on a recognised stock exchange and must not be an open-ended investment company. It must also distribute most of its profits for each accounting period. For investment real-estate-related businesses an alternative would be an offshore holding company and property company structure that does not require a public listing or trading but will enable the structure to benefit from keeping gains offshore not subject to UK capital gains tax. Such businesses will be non-resident landlords and be subject to income tax on rental income.

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33 Are there particular legal considerations that shape the formation and activities of real-estate-focused private equity funds? Does this vary depending on the target assets or investors?

Real-estate-focused private equity funds are collective investment schemes (CIS) for the purpose of the FSMA. CIS are widely defined to include any arrangement that enables a number of investors to pool their assets (that is, property of any description, including money) and that are managed with a view to participants sharing profit or income there from.

FMSA requires that regulated and unregulated CIS be operated and promoted by an FCA regulated operator as establishing, operating or winding up a CIS is a specified activity and so, when carried on by way of business, is a regulated activity, and FSMA generally prohibits persons from carrying on regulated activities unless they are authorised or exempt persons.

FSMA also contains restrictions on the promotion of regulated and unregulated CIS. The promotion, and therefore the sale, of regulated CIS to the general public is limited to FCA authorised persons, or must be approved by an authorised person. The promotion of unregulated CIS (UCIS) to the general public by authorised persons in the UK is, however, prohibited except in certain circumstances for example to sophisticated investors and high net worth individuals for whom these products are more likely to be suitable.

Real-estate private equity funds are further subject to the Alternative Investment Fund Managers Directive (AIFMD) which provides a harmonised regulatory framework for EU-established managers of alternative investment funds (AIFs), including requirements relating to authorisation, administration, remuneration, marketing and depositaries. The AIFMD was implemented in the UK by a combination of HM Treasury statutory instruments, including the Alternative Investment Fund Managers Regulations 2013, and FCA Handbook rules.

An alternative investment fund manager (AIFM) is a legal person whose regular business is to manage one or more AIFs. An AIF is a non-UCITS 'collective investment undertaking' that raises capital from investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors. This definition catches non-UCITS funds such as private equity funds and real estate funds, among others.

Small fund managers with assets under management (AUM) not exceeding certain thresholds (ie, with AUM either not exceeding €500 million in total provided the portfolios of AIFs consist of AIFs that are unleveraged and have no redemption rights exercisable during a period of five years following the date of initial investment in each AIF; or €100 million in total in other cases, including any assets acquired through the use of leverage) do not need to comply with the full requirements for authorisation as an AIFM but are required to be authorised or registered with the FCA, or to opt in to the full requirements of the AIFMD. A small external manager of certain real estate funds, for instance, is required to register as a small UK AIFM. For a small fund to opt in to be treated as if it managed assets above the threshold and become fully authorised, with the result that the full requirements of AIFMD apply to it, has the benefit that it is then entitled to manage and market AIFs in other EEA states under a passport.

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