European Real Estate Finance: Recent developments

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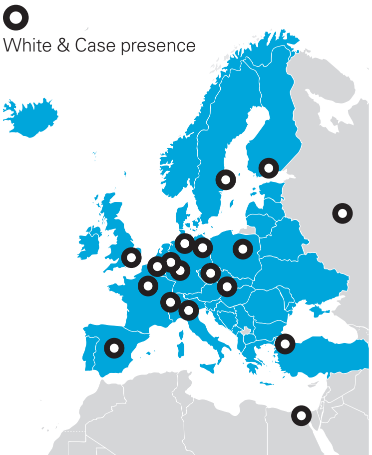
As part of our periodic updates, here is an overview of recent developments of relevance to participants in the real estate finance market across certain key jurisdictions in Europe.

Countries featured in this edition

White & Case presence



Europe

LIBOR Discontinuation

As we mentioned in one of our previous alerts (available here), LIBOR is expected to be discontinued from the end of 2021. Replacement benchmarks have been selected for all five of the currencies currently supported by LIBOR, with SONIA selected as the sterling replacement, SOFR as the dollar replacement and €STR selected as the euro replacement. It should be noted, however, that the European Money Markets Institute has been granted authorisation by the Belgian Financial Services and Markets Authority for the administration of EURIBOR under the EU Benchmarks Regulation; and accordingly EURIBOR is expected to continue post 2021. Further information on the impact of these changes on the loan market are available here, here and here. In relation to the commercial real estate finance market, we also consider whether the discontinuation could affect the popularity of fixed rate loans, here.

In September of this year, the Loan Market Association published exposure drafts of facilities agreements, showing the possible inclusion of SOFR and SONIA. Given both of these rates are daily overnight rates, the documents use a compounded average of the relevant rate calculated in arrear, using an observation period starting before the start of, and ending before the end of, that Interest Period. The drafts assume that a screen rate will be available in due course, failing which Agents will be expected to calculate the rate. Separately, in October, the LMA Market Association published an exposure draft of a "Reference Rate Selection Agreement". The intention behind the draft is to streamline the transition process by creating a single standardised approach to amending legacy facilities agreement. The use of this agreement assumes a two-stage approach whereby the Reference Rate Selection Agreement is used to agree commercial terms, followed by an amendment agreement to effect those amendments. At this stage, these exposure drafts are not intended for use in the market, but instead to raise awareness of the types of changes that will be required to documentation and to elicit feedback from the market on those changes.

2020

EUROPE

Political and economic uncertainty clouds the outlook for Europe in 2020, and yet investors remain drawn to the income-generating attributes of real estate

Source: PwC Emerging Trends in Real Estate 2020

€4.4bn

FRANCE

An influx of capital totalling €4.4 billion has come from South Korea in 2019 targeting mostly La Défense where vacancy and yields are slightly higher than in the rest of Paris

Source: PwC Emerging Trends in Real Estate 2020

France

Updates to penalties for erroneous or missing TEG

On 17 July 2019, the French Ordinance No. 2019-740 was adopted, standardising the penalties payable for errors or omissions in calculating both the taux annuel effectif global (which applies, generally speaking, to consumer lending) and the *taux effectif global* ("TEG", which applies otherwise).

In transactions involving French borrowers, there is a requirement to specify, in any loan agreement, the TEG, i.e., the annual all-in rate applicable to a loan. This rate must include interest and all direct and indirect costs, taxes and fees of any kind borne by the borrower as a condition to the loan. The lenders/the agent must specify both the annual rate and the period rate. With TEG rules being complex and giving rise to various interpretation issues, certain consumer loans and "toxic" structured loans made to public entities have become fertile ground for TEG litigation in light of the potential sanctions incurred by the lenders for erroneous or missing TEG.

Amongst other sanctions, a judge could hold the interest clause null and void or, as the case may be, deprive the lender of its right to interest contractually agreed, save for very limited exceptions. Instead, the lender could have been left with a statutory interest rate (*taux d'intérêt legal*) as from the date of the loan agreement. However, with the reform arising from Ordinance No. 2019-740, the civil sanction for TEG error or omission would now result in the lender being deprived of "the right to interest in the proportion fixed by the court, with regard to, in particular, the prejudice for the borrower". This effectively means that the penalty will now be determined at the discretion of the courts on a case-by-case basis, taking into account any damage suffered by the borrower. With such changes, one hopes the penalties provided will be more closely aligned to EU requirements of being effective, proportionate and dissuasive

Interestingly however, although authorised by the Parliament, the French Government has decided not to proceed with reforms to abolish the obligation to provide such a TEG in the context of corporate lending, instead opting to maintain the rules for all stakeholders.

3.1%

GERMANY

Office vacancy in Hamburg is extremely low, standing at 3.1 percent at the half-year mark

Source: PwC Emerging Trends in Real Estate 2020

Germany

Rent price cap in Berlin

On 2 September of this year, a draft bill was published by the Berlin Senate applying a rent price cap to residential apartments in Berlin, scheduled to become effective from January 2020. The bill effectively freezes rent levels for all existing apartments for five years. Landlords would also be precluded from passing on any additional costs associated with inflation. The cap is intended to apply to existing leases and new leases.

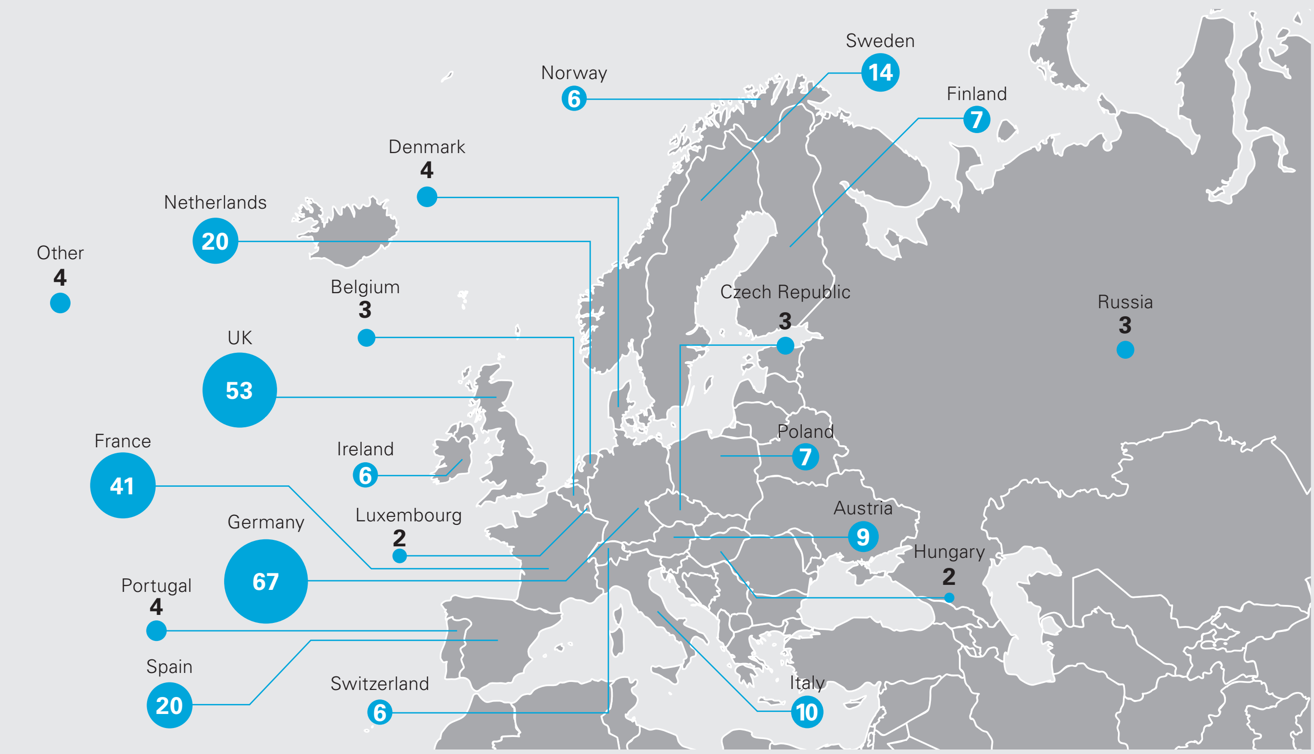
Real Estate Transfer Tax – draft legislation available

In one of our 2018 updates (available here), we informed you of the proposed changes that had been agreed to the real estate transfer tax provisions ("RETT"). This included changes to the threshold for RETT (from 95 to 90% ownership) and extending the holding period (from 5 to 10 years) during which the RETT payment is triggered were some of the proposed changes. Earlier this year, draft legislation was made available for review. The draft bill, in most respects, corresponds with the proposals that were put forward by the German Federal States and, therefore, reflects the points the market was expecting to see.

One interesting point that has come to light, however, is the scope of application of the rules. The draft bill contemplates that the new rules will apply from 1 January 2020. However, it is unclear whether it applies to new transaction only or whether it applies to transactions for which RETT payments would fall due after this date, assuming the new rules apply to them. For example, should it apply to transfers made within the last ten years, to take account of transactions within the ten-year holding period referenced above? A clarification on this would be helpful prior to the legislation coming into force.

In addition, rumour has it that an exception for publicly listed corporations would be introduced.

Country transaction volumes Q4 2018 – Q3 2019 (€ billion)



Source: Real Capital Analytics
Note: Countries with transactions over €1 billion

Italy

Securitisation of real estate assets

Over the last few years, Italian law 30 April 1999, No. 130 ("Law 130") concerning the securitisation of receivables has been amended several times and its scope of application has been broaden to new types of transactions. In particular, Law 30 December 2018, No. 145 (so called "2019 Budget Law") and Law Decree 30 April 2019, No. 34, as converted into Law 28 June 2019, No. 58 (so called "Crescita Decree") have introduced new rules concerning, *inter alia*, the securitisation of real estate assets.

Under the new rules dedicated special purpose vehicles ("RE SPVs") can be incorporated to acquire and securitise real estate assets, registered movable assets, rights *in rem* or personal rights over such categories of assets. RE SPVs are prohibited from implementing any other securitisation transactions of different nature.

A third party services provider (with appropriate experience and holding the required authorisation under applicable law and regulation) is required to be appointed to administer and manage the relevant assets on behalf of each RE SPV in the interest of the noteholders. For each transaction the parties identify the rights and assets to be segregated in favour of the noteholders. The rights and assets so identified constitute a segregated pool separate from the rights and assets pertaining to any other securitisation carried out by the same RE SPVs.

Unsurprisingly, the new rules are posing some interpretational issues (especially as to the extent of the segregation regime and the rights of third party creditors over the securitised assets), which are currently discouraging investors and their advisers from the use of such new structures. The new approach remains important though. In the near future, RE SPVs and real estate securitisations could prove to become a more flexible and cost efficient investment scheme alternative to traditional real estate funds. It could also allow interested parties to achieve cheaper financing terms by tranching the risk associated with traditional real estate transactions and placing each segment of risk to different lenders, including non-banking entities. Readers are, therefore, advised to keep abreast of developments in this area.

€600

per square per annum

ITALY

Milan's top rents, due to demand for modern spaces from diverse tenants, is higher than many European cities outside of Italy

Source:
PwC Emerging Trends in Real Estate 2020

Europe's 10 most active markets, Q4 2018 – Q3 2019 (€ billion)

Source: Real Capital Analytics

Poland

Update on Polish tax reforms

In our last alert (available here), we informed you of the new Polish withholding tax regime, which effectively made it more difficult for Polish tax residents to apply for withholding tax ("WHT") exemptions or reduced withholding tax rates. The regime took effect from 1 January 2019 and we are now providing an update on the new regulations and the approach to this regime.

On 19 June 2019, the Polish Ministry of Finance published draft "tax explanations" regarding the rules for applying the new withholding tax regulations. The purpose of the draft explanations was to help foreign entities obtain payments from Poland and enable Polish tax remitters to re-evaluate their position with respect to withholding liabilities in Poland. However, as a number of issues were not explained, the new withholding tax regulations in Poland still remain unclear and difficult to apply in practice.

Presumably as a result of the above, on 27 June 2019, the Polish Minister of Finance issued a new regulation, which deferred the entry into force of the main rules of the new withholding tax regulations, i.e., upfront payment mechanism with the refund right applicable to payment exceeding PLN 2 million per year, as defined by the specific regulations, until the end of December 2019. In other words, under the minister's regulation, the obligation to collect withholding tax at the domestic maximum rates, regardless of the relief at source available under a double tax treaty or EU tax directives, has been deferred.

In practice, withholding tax regulations in Poland are currently governed by two regimes: (i) the previous regime in the form applied before 1 January 2019 (with certain amendments); and (ii) the new withholding tax regime, which should have entered into force from 1 January 2019, but, due to its deferral, will now be effective from 1 January 2020.

The simultaneous application of the two regimes results in uncertainty in the market for both taxpayers and tax remitters. As the new withholding tax regime is not expected to be significantly amended, the market expects the publication of clear official explanations (that are not simply in draft form).

c.€1.9bn

POLAND

Transaction volumes in Warsaw as of Q3 2019, with full-year transaction volumes already set to exceed transaction volumes from earlier this decade

Source: Real Capital Analytics

11%

SPAIN

The average rent in periphery submarkets of Barcelona has been driven up by 11% due to lack of available space in the city centre

Source: PwC Emerging Trends in Real Estate 2020

Spain

Secured Claims in insolvency

The Spanish Supreme Court is moving its criteria on certain insolvency issues. As per the recent decisions (numbers 112/2019 and 227/2019), the amount secured by a mortgage shall comprise both principal and interest, either accrued before or after the insolvency declaration, so long as such amounts are covered by the proceeds obtained from the enforcement. However, only default interest accrued (and falling within the scope of the "secured obligations" agreed in the mortgage) before the insolvency declaration are secured. The Supreme Court argues that once insolvency is declared, the debtor is legally restricted from paying interest and accordingly it did not consider it appropriate for default interest to accrue after such an insolvency declaration.

Those decisions have also clarified that a secured creditor should provide notification of two different claims once insolvency is declared: its claim related to the principal and interest accrued before and up to the insolvency declaration and its claim related to interest accrued after the insolvency declaration (which shall be a contingent claim).

Scholars and practitioners did not expect this movement by the Spanish Supreme Court. However, it should be noted that these two decisions are not consolidated case law as of yet, so it will be interesting to see if further decisions in this area consolidate the new interpretations.

Mortgage-backed loans index references

A Spanish first instance court has filed a request for a preliminary ruling with the European Courts of Justice the "ECJ"). The genesis of the request is that a bank customer has alleged that its bank's mortgaged-backed loan terms (with the customer's residential property forming the collateral) are unfair, contrary to the terms of The Unfair Contract Terms Directive 93/13/EEC (the "Directive"), as the bank uses *Índice de Referencia de Préstamos Hipotecarios* ("IRPH"), whereas most residential loans are indexed by reference to EURIBOR (approximately 90%). The Directive protects consumers against unfair standard contract terms imposed by traders. It requires that standard contract terms are drafted in plain intelligible language and ambiguities are to be interpreted in favour of consumers. If contract terms are considered to be unfair, they are not binding on consumers if, contrary to the requirements of good faith, they cause significant imbalance in the parties' rights and obligations to the detriment of the consumer.

Requesting a preliminary ruling, the Spanish first instance court stated that this dispute fell within the scope of the Directive; and therefore was within the jurisdiction of the ECJ on the basis that (i) EURIBOR is a more beneficial rate for customers as IRPH leads to a higher cost; and (ii) there were concerns around the information shared with the customer before the contract was signed.

Filing his conclusions, the General Advocate of the ECJ held that this case did fall within the jurisdiction of the Directive, as Spanish legislation did not impose the use of IRPH. Accordingly, information provided to customers needed to be such that the consumer is able to make a conscious and careful decision. He concluded that the decision as to whether those requirements had been met should be decided by the Spanish courts. The ECJ's conclusions are currently pending and it will be interesting to see whether they agree with the General Advocate. If it does so, it could lead to a rise in proceedings in Spain on this topic.

United Kingdom

Leasehold Reforms

On 15 October 2018, a consultation had been launched with the intention of identifying areas of reform required to the leasehold system, which the Government had noted as being subject to unfair and unreasonable abuse. A summary of the feedback from the consultation had been made available on 27 June 2019. In July however, the Government released a response to that feedback, where it outlined proposals for change to the leasehold system. The key changes outlined were as follows:

- a ban on the creation of any new long residential leases, such that it is not possible to register a non-compliant lease with HM Land Registry. Instead all new houses are to be sold on a freehold basis (with limited exceptions).

On any application to register a new lease, the applicant will need to declare that the lease is not in contravention with the legislation (they are within the scope of an exception).

- If a lease has been granted in contravention of the ban, the buyer will be entitled to the right to buy the freehold at any time after the point of sale. This is also known as a 'zero cost enfranchisement'. The Government were of the view that such measures will deter behaviour in contravention of this, as such developers would be liable for the cost for such enfranchisement.
- A reduction in the ground rents that can be charged for future leases to a peppercorn (or zero financial value). As part of the consultation process, the Government had suggested a £10 per annum cap, but this has now been reduced down to zero.

The proposals for leasehold reform is potentially one of the biggest changes to the housing market for the past decade. The timing for implementation currently remains uncertain and, therefore, interested parties are advised to follow any future developments.

Overseas Entities Bill

In one of our previous updates (available here), we informed you that in July 2018, the UK Government confirmed its intention to pass the 'Overseas Entities Bill'. The purpose of the proposed legislation is to improve transparency in relation to overseas entities owning land in the UK, such that an overseas entity would need to apply for registration at Companies House before it could complete its proposed purchase.

The draft bill was viewed positively in a report by the Joint Committee of the House of Lords and House of Commons in May 2019. In July, the Government responded to the observations the Committee had made. Some of the points noted were as follows:

- *Definition of legal entity* – the Committee had suggested a clearer definition of "overseas entity" was required and also suggested a pre-clearance mechanism and a dispute resolution procedure to determine whether an entity was registrable. The Government noted that a pre-registration mechanism would not be introduced, but rather it will provide clarity on which legal entities are caught under the legislation through guidance and explanatory notes.
- *Threshold for registration* – the Committee proposed that the threshold for registration be lowered below the current 25% ownership / voting requirement. The Government proposed to keep the threshold under review, but did not currently intend to lower this threshold as it is in line with global norms on beneficial ownership.
- *Trusts* – the Committee noted that trusts may be used to circumvent the obligation to register. The Government recognised this issue and set out ways it intends to overcome this issue, such a requiring a declaration, at the time of registration, that the entity is not representing a trust.

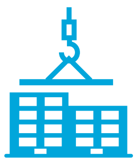
It is the Government's intention that the legislation take effect from 2021.

4.5%

UK

Manchester city centre is the most attractive residential market with a 4.5% average growth forecast over the next five year

Source:
JLL, as noted in PwC Emerging Trends in Real Estate 2020



4.5 – 4.75%

UK

Prime office yields stand at 4.5 to 4.75% in Edinburgh

Source:
PwC Emerging Trends in Real Estate 2020

Beneficial Interest in Property from Resulting Trust

In June 2019 the High Court was asked to consider the County Court's finding on whether an informal oral agreement could give rise to a transfer of beneficial interest in property to an occupier. In the case of *Mohammed Tahir v Ul Hassan Faizi [2019] EWHC 1627 (QB)*, the respondent claimed there had been an oral agreement that the appellant would purchase a property in his own name, on behalf of the respondent. The respondent was unable to do so, due to his immigration status. The respondent paid the deposit and paid the monthly mortgage payments directly to the lender for approximately three years. Throughout this time, the respondent lived in the property with his family and even undertook work to the property.

The appellant, however, argued that this was not the agreement. The appellant claimed that the agreement was purely a landlord and tenant relationship, with the respondent simply paying rent. The appellant however, resided mostly in his country of origin, and did not check on the property or the respondent throughout the duration of the agreement – which the Court found unusual for an agreement that is an alleged landlord and tenant relationship.

The Court therefore upheld the previous decision that the respondent held the entire beneficial interest in the property and confirmed that this interest arose by way of resulting trust. The case provides a useful illustration of when and how a resulting trust can arise despite a lack of family connections, written agreements, and informality. The case also highlights the importance of having written agreements between parties, where possible, for the avoidance of doubt and dispute.

Sub-Buyers Assertion of Proprietary Rights

In June 2019, the High Court was asked to consider whether a sub-buyer under a non-completed contract can assert proprietary rights against a head seller. In the case of *Conn & Anor v Ezair, Re Charlotte Street Properties Limited [2019] EWHC 1722 (Ch)*, the joint administrators of Charlotte Street Properties Limited applied for an order for the legal owner of multiple properties to transfer the title of those properties to it as a sub-buyer.

Mr Ezair had contractually agreed to sell his properties to Northern Estates Limited, who in turn had agreed to sell the properties on to Charlotte Street Properties Limited. Although both Mr Ezair and Northern Estates Limited received consideration for the agreement (with Charlotte Street Properties Limited also treating the properties as assets on its accounts), the transfer of legal title to the properties was not executed.

The Court held that Charlotte Street Properties, as sub-buyer had contracted to buy six properties and had a beneficial interest in those properties. This was considered to be enforceable against Mr Ezair, who was compelled to transfer legal title to Charlotte Street Properties Limited, despite the fact there was no privity of contract between them and despite the fact the contracts had not been completed. The case provides a useful illustration of when and how a sub-sale arrangement can catch those who were not privity to the contract, but furthermore, it also demonstrates that careful consideration must be given to any sub-sale arrangements as part of the property due diligence process, even if the transfer of property has not been completed.

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