REFLEXIONS

A BI-ANNUAL DIGEST FOR THE REAL ESTATE INVESTMENT MANAGEMENT INDUSTRY

Issue 01 — April **2015**

The UK real estate market in the spotlight—What will 2015 bring about?

The real estate investment management industry—Looking ahead

Risk management in real estate—What keeps real estate managers up at night?

Wind of change—Towards a mainstream-like operating model for the real estate industry

From private placement to AIFM distribution—The new way to sell alternative investment funds

The real estate investment industry in the face of BEPS—Potential impacts, opportunities and threats

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Foreword

Dear readers,

"No man ever wetted clay and then left it, as if there would be bricks by chance and fortune"
– Plutarch

Nor is there success in real estate by chance and fortune, but by professionalism and diligence.

At Deloitte we have long recognised this and we believe that real estate cannot be lumped together with other asset classes, but deserves - and even demands - a voice of its own. We are therefore particularly pleased to bring you this first edition of REflexions, - a magazine about real estate investment management, written by real estate professionals for the real estate sector and concentrating on that one unique theme.

Welcome to this, our first dedicated real estate investment management publication. We shall be publishing the magazine twice a year with a mix of features on market trends and technical issues – such as tax and regulation – as well as interviews with leading figures in the real estate funds world.

Our first edition holds an interview with Pieter Hendrikse, CEO and Chairman of CBRE Global Investors in EMEA, who leads the European business of one of the world's largest real estate manager by assets under management. He kindly agreed to talk through his business plans and challenges with Paul Meulenberg, who is responsible for Deloitte's real estate business in the Netherlands. Our market commentary will focus first on the UK where Deloitte Real Estate's research lead, Will Matthews, highlights reasons to expect a strong 2015 following on from an exceptional 2014.

On operational matters, Dmitri Tsopanakos who leads our Investment Management Risk Analytics business in London, tells us about the evolving focus on risk management within real estate fund managers and David Capocci from Deloitte Luxembourg addresses the first wave of expected tax changes arising out of the OECD's Base Erosion and Profit Shifting (BEPS) project.

The Deloitte Real Estate business across Europe and the Middle East comprises teams covering real estate transactions, management, development and valuation as well as financial advisory, accounting, tax, regulatory and strategic consulting services. We aim to bring you insights across all aspects of the real estate spectrum through our unique combination of deep financial knowledge and property skills.

Would Plutarch approve? We cannot know, but we sincerely hope you will find something of interest in this issue. We would welcome your feedback to tailor future issues to your needs, so that we can contribute our own form of building blocks to the success of your business.

Benjamin Lam
EMEA Real Estate Funds Co-Leader

David Brown
EMEA Real Estate Funds Co-Leader

The UK real estate market in the spotlight

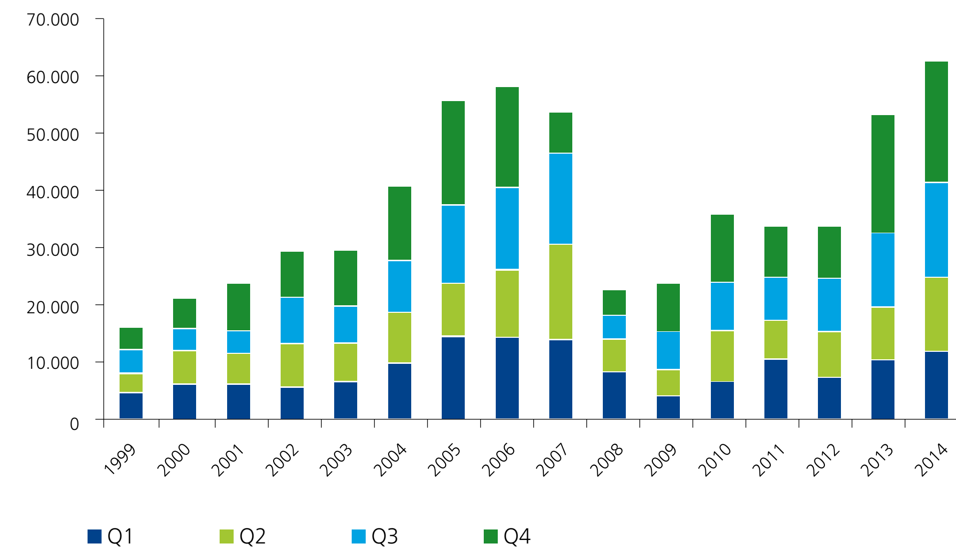
What will 2015 bring about?

William Matthews
Senior Manager
UK Real Estate Research Lead
Deloitte

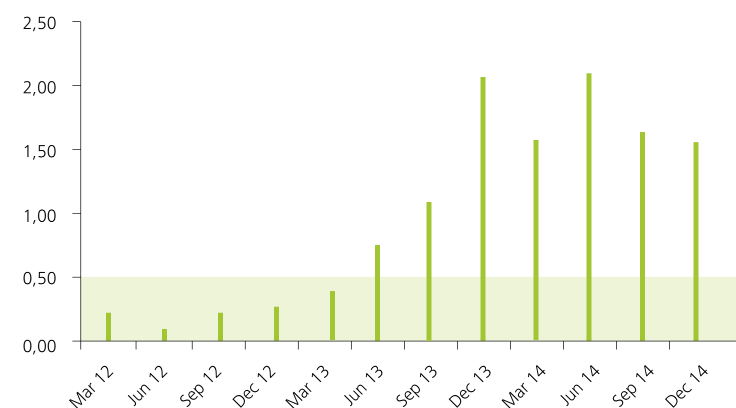
Now that the dust has settled on 2014, it is becoming clear just how strong a year it was for real estate returns generally and the UK in particular.

Headlines point to phenomenal performance with total UK returns reaching their highest level for many years, but behind this we have seen some fascinating developments. Waves of new investors, an occupier market changing at a rapid pace – driven by technological disruption and economic shocks, both positive and negative - the twists and turns of new regulation and evidence of increasing M&A activity in the sector are all part of what made 2014 a particularly exciting year.

UK investment volumes by quarter (£million)



UK Month-on-month total returns (%)



Given this backdrop, it is perhaps unsurprising that the consensus envisages a moderation in performance in 2015, but our view is that this cycle has further to run. We are confident the UK economy will show reasonable growth, even if the pace will be more measured than last year. This will provide a solid foundation for another year of robust performance, with further yield compression and improving rental growth.

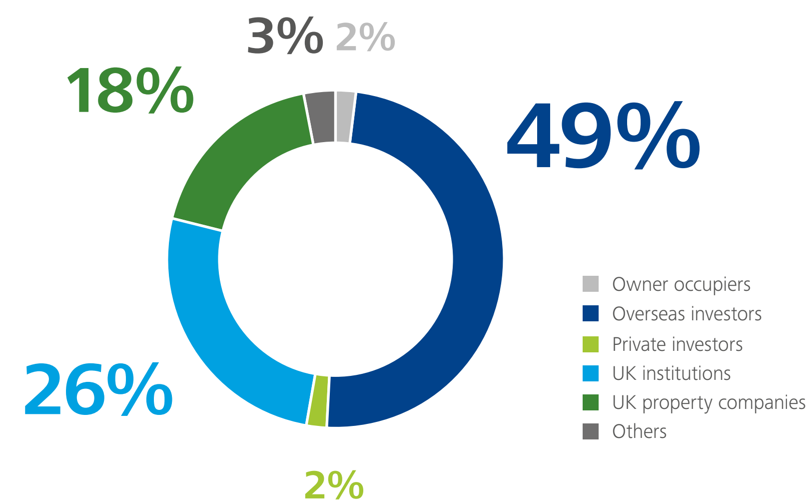
Indeed, rising occupational demand is taking hold as the economy expands, and not just in London. Deloitte's recent 'Businesses Leading Britain' report found that two thirds of the UK's fastest growing medium-sized companies are now based outside London and the South East.

So far, however, new office construction is struggling to keep pace with demand in some locations, and this scarcity will support rental growth prospects.
The relatively low pipeline of new office space in London is now well understood, but our research shows that a similar picture exists in a number of regional markets.

For example, our recent Manchester Crane survey showed that, although office construction is rising, delivery over the next two years will be modest, and availability of Grade A space has dropped to less than half its 2009 level. Our Leeds Crane survey shows a more marked rise in projected office completions over the coming years, although just as in Manchester, a period of very weak construction activity means availability of Grade A space remains limited.

Neither do we see any signs of a let-up in demand from the wide range of investor groups targeting UK real estate: be it domestic institutional investors, overseas pension and sovereign wealth funds or the man on the street topping up his savings in retail funds, enticed into property by its recent track record. Amongst those increasingly active in the UK we single out UHNWIs (Ultra High Net Worth Individuals) as ones to watch in 2015. Having quietly built their share of investment transactions to a sizeable level, family offices now represent a significant force in the market.

Share of investment by investor type Q4 2014



We are also witnessing investor interest in a broader range of property types. In addition to fierce competition for office stock, demand for industrial and logistics property institutions has increased, with institutions and funds particularly active buyers. Meanwhile, shopping centres have also been the focus of strong investor interest and an increasing number of transactions have been conducted off-market as vendors have been confident of achieving asking price.

With so much competition for UK property, some investors will inevitably find it difficult to deploy capital quickly and efficiently. Those with large allocations to UK property may decide that it would be easier to purchase an existing real estate investment vehicle, with a management team in place, and the recent Songbird (Canary Wharf) bid supports this thesis.

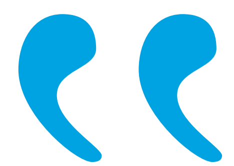
Like many, we still have concerns over particular parts of the market. Alarm bells are ringing for superstores - the race for space has left some retailers over-exposed to large out-of-town sites at a time when the consumer appetite for convenience increasingly favours the high street, and discounters are stealing a march. We expect that a continued rise in small, frequent shopping trips will support convenient locations that form part of people's daily transport routes: local high streets, stations or other major transport hubs, for example. These will become the ultimate convenience shopping pitches.

The evolving demand for different types of space is not limited to retailing. In fact, we believe that the UK's office sector is beginning to feel the effects of the tech revolution that is already rapidly transforming both retail and industrial property. Our recent research has highlighted the potential for a third of UK jobs to be automated and that future employment growth will be focused on more cerebral, creative and collaborative job types.

The current regimented style of office accommodation will not be the best fit for employees in these jobs, who benefit from being able to work in a variety of spaces depending on the task at hand.

We are starting to see office design respond to some of these needs, but it is becoming increasingly apparent that creating high quality working environments requires the close alignment of a company's talent, technology, location and building strategies. Most organisations will not see this integration completed in 2015. In fact, many are only starting on this route, but they will recognise that the office is a hugely valuable component in their overall offer to staff.

As we look to what 2015 has in store, one thing is for sure: it looks set to be another dynamic year. Success will be measured by the ability to navigate through the fast changing world in which we now find ourselves.



The real estate investment management industry Looking ahead

Deloitte Partner Paul Meulenberg meets Pieter Hendrikse, CEO & Chairman of CBRE Global Investors, EMEA region.

Pieter Hendrikse led the European Real Estate Investment Management activities of ING Real Estate for a number of years until they were taken over by CBRE Global Investors in 2011. ING Real Estate was one of the biggest real estate companies in the world, with investment management, finance and development activities on the global real estate market. Pieter assumed the role of CEO and Chairman of CBRE GI for the EMEA when the acquisition took place. He also sits on the global executive board of CBRE GI.

Deloitte: ING Real Estate Investment Management joined CBRE Global Investors in November 2011. How did the integration go?

Pieter Hendrikse
ING Real Estate, which was developed on the back of their insurance company at the time, was one of the world's leading real estate companies. ING Real Estate's expertise and 'art of real estate' were key factors in attracting talent. Fortunately, CBRE was able to continue that spirit and philosophy when the ING team was transferred to CBRE and eventually merged into CBRE Global Investors.

What we have today is a real estate investment management company seeking to be one of Europe's leading investment managers without any financial or pension fund and insurance company back-up. We are now fully independent from any financial institution, which is quite a novelty. The combination of ING's spirit and talent with the independence and overall infrastructure of CBRE Global Investors is a perfect match. Another big advantage gained from the merger was that client overlap stood at only 4 to 5%, meaning there was no turbulence, shake out or diversification problems. Our strategies also differed: CBRE came up with more value-added investment strategies, whereas ING had a more of a core investment strategy.

> When we acquire a property, a sustainability check is an important part of our due diligence procedures

Deloitte: How have clients and investors responded to the merger?

Pieter Hendrikse
As the process began in the midst of the 2010/2011 financial crisis, feelings were initially mixed, and ranged from understanding the reasoning of ING's decision to concern about losing their management. Clients and investors therefore followed the situation very closely, and we gave their concerns and our responsibilities towards them our full attention.

We identified three important stakeholders, focusing on the seller or owner, as well as the new owner, while maintaining complete commitment to our clients and our people. We have succeeded in preserving this very tight circle.

We had also consulted clients to seek their approval for this move. An initial agreement between the seller (ING) and buyer (CBRE) was reached in December-January 2010/2011, but it took ten months to fully accommodate the different stakeholders, such as investors, the different banks, works councils, etc. Ultimately, we came out of this process in a good position. Clients responded very positively, but it took time. It was a very intense project, but we always kept our goal in sight.

Deloitte: Where do you stand today?

Pieter Hendrikse
To explain where we stand today, I would like to broaden the scope a bit. We launched a lot of businesses and funds in the early 2000s. All of these businesses launched between 2000 and 2005 had a life cycle of ten years. Our merger in 2011, industry changes brought about by the financial crisis and the funds reaching the end of their lives meant we had to take action.

We had to really take responsibility for our clients, which meant that we had to make very serious decisions to not only try to continue with these funds, but also to control fund termination and liquidation. The structure of the investment programme, rather than the quality of the underlying assets, occasionally forced us to sell. Investors also learnt a lot about the effects of leverage and consolidation in the pension fund and asset management worlds.

As a result, they also see their levering partners in the same vehicle as a different kind of partner than in the past, when setting up the fund together. We had many changes to deal with and many decisions to take. But the benefits of such a merger, and of a new culture/DNA, along with a strategic review of the business with the right kind of decision making and the right new leadership has led to the very healthy situation we find ourselves in today.

Deloitte: What are the major challenges you are facing for the years to come?

Pieter Hendrikse
The challenges are first of all to accommodate the capital available for investing in real estate. We all saw the wall of money available between 2004 and 2007, of which a large part came from debt opportunities, highly sponsored by banks. Today, we talk about 'real' real estate investors, focusing on a long-term investment strategy (finding the right investments with the capital available) rather than on short-term strategies (such as trading with real estate). What the real estate sector has done extremely well is to become transparent and accessible.

It has the right dimensions and tools to be considered as a professional asset class in Europe in addition to bonds, equities and maybe alternatives such as infrastructure. Now the challenge the industry is facing is that there might not be enough high-quality investable real estate to match liabilities. In my opinion, the job of today's investment manager is to ask where the best real estate is and which asset or building is going to stand out. This is quite a challenge.

Deloitte: How do you stand out from your competitors in the real estate investment industry?

Pieter Hendrikse
First of all, by our local presence. We have offices in every European capital, each staffed by a team of 30-40 people. We use our local relationships to be number one for off- and on-market deals. We have local acquisition people, who focus exclusively on acquisitions, and a management team to take responsibility for the investment. And we do not buy just for the sake of it; we know what kind of property we would like to buy in line with our clients' investment strategy. How do you decide what represents a good or a bad deal for a client? How do you choose which deals to start working on and which to avoid? Well, firstly you need to know your client to know exactly what they want. This means keeping the dialogue completely open; you should not just throw assets at the client and let them decide. You are being asked to invest, and you have to have the skills and expertise to know what they want and bring that to the table.

This means we make a number of deals every day. We made more than €3 billion of acquisitions last year, but also recorded sales of €2.5 billion.

A transaction level of €5.5 billion represents almost 20% of the total asset base of €30 billion we hold as a European company.

Deloitte: How is the real estate investment management market going to develop over the next 5-15 years?

Pieter Hendrikse
I believe that all the new rules in the banking and insurance industries, the Volcker rules and the fact that financial institutions will eventually decide that real estate investment management is no longer a core activity will trigger more strategic moves such as ours. In Germany, the Netherlands, the UK and the Americas, people are going to take a truly strategic approach to deciding what to do with their in-house real estate investment management activities.

I would not call it a shake-out because that has negative connotations, but see it more as a strategic repositioning on the current owner and management side. I also think we will see consolidation between investment managers, meaning that the number of real estate investment managers will eventually decrease. This is going to throw up some questions from allocators and investors, as they are happy with the various options and opportunities currently available when choosing an investment manager. This is something to keep in mind for the future. In addition, we also see those who have learnt the trade over the last few years starting their own niche boutique management platforms.

As a result, investors will finally be able to choose to go for a perfect alignment with the owner of a specialist management platform instead of an investment house like us. However, execution on the ground is going to be crucial. This is what investors will seek, meaning that an investment manager in real estate must be able to demonstrate executional and operational excellence on the ground to perform and deliver excellent returns to investors.

Deloitte: Returning to the topic of consolidation, in the future, do you expect there to be fewer real estate investment managers than there are now? If investors have less choice, could they increasingly begin investing themselves and you do separate account business for them?

Pieter Hendrikse
We should remember that we have seen consolidation among investors themselves too. Allocators are also merging and building investment management activities servicing their pension funds — there are several examples of this. The question is whether they will set up their own specialised real estate investment management organisation. If not, they will stay as an allocator and will simply find their real estate investments listed and non-listed. For non-listed real estate investments they will select external managers.

Alternatively, if they do start building up their own real estate expertise, they, as a manager, will want to be treated as a separate account with CBRE. This is nothing new, and has been around for years. However, as a manager you have to customise and organise this accordingly. In fact, if the amount of capital to be invested is sizeable, you could treat it as a fund. Whatever strategy comes with the account, you have to have dedication, a line of interest and also the commitment of the respective managers.

We do not buy just for the sake of it; we know what kind of property we would like to buy in line with our clients' investment strategy

Deloitte: You have €30 billion in assets under management, part of which is separate accounts, part of which is funds. How is this division going to change and would you expect more separate accounts instead of funds in the future?

Pieter Hendrikse

Back in 2010 the split between funds and separate accounts was 90/10, while it might be 70/30 in 2015 and move towards 50/50. Although the volume of funds will decrease, they are here to stay. With all the funds launched from 2000 to 2005 coming to an end, investors were not comfortable with the concept of funds and wanted to get out. Funds are too complicated, they do not have proper governance, there are no likeminded investors, investors feel they have no adequate voting power, the manager has differing interests to those of the investors, etc.

That being said, join ventures and co-investments are also very complicated, meaning that they are not a good alternative to funds. Does this make separate accounts a good alternative? For some the answer is yes, as they feature extended governance and a direct relationship with investment managers, allowing you to be in full control of your destiny. However, we are also seeing more investors coming to Europe and wanting to team up with other like-minded investors, leading to a club deal, or back to a fund. Other investors have also learnt their lessons. They prefer to club together with other investors, putting an increasing amount of money into one basket without excessive leverage like in the past.

They aim for a common strategy, and already have the right managers. This will result in a balance between investments via funds and separate accounts.

Five years from now, more international separate accounts from non-regional allocators will invest in the European region as a separate account. In fact, we already have examples of this in the form of Asian, American and Middle Eastern investors. They want to invest by themselves, with the support of a local manager, as this is what they are doing on their domestic markets.

Deloitte: When being part of ING, you could start an investment fund on the back of ING insurance funding and then attract additional outside investors. As CBRE, how do you initiate a fund without the availability of seed capital?

Pieter Hendrikse

Indeed, we now initiate funds without a sponsor putting in substantial seed capital. However, in selected cases we do obtain smaller co-investment sponsorship from CBRE Corporate. These days, if we launch new products we obtain co investment from the group first, and also have co-investment from the fund management team and European leadership. Most importantly, we are able to sell the product thanks to our track record and performance in general. Then it all comes down to knowing how to organise, acquire, manage, perform, report, really stand out from the competition, and finally, deliver.

Deloitte: There is increasing competition amongst international real estate investment managers. The European real estate markets are shaping up, and if an investment opportunity appears, you need to act swiftly. How is CBRE prepared for that?

Pieter Hendrikse

We are indeed prepared. In fact, every other day we have an Europe-wide conference call to talk about market opportunities, ensuring we consider every single one. We are perceived to be an active investor, so are regularly asked by third parties to come up with an investment solution to help them out. We know exactly how to organise our decision making and there are strong connections between the small number of management layers. The beauty of this company is that we focus on doing business in the interest of our clients. We have never lost a deal because of timing or internal obstacles.

Deloitte: Where do you want to stand in 2020 in terms of volume of assets under management and organisation?

Pieter Hendrikse

I am convinced we have what it takes to be successful over the next five years leading up to 2020. However, we should remember that this is a completely new situation for many, and we have made a number of organisational changes. We have a lot of new leaders, a lot of new strategies and a new organisational and business model. We have a more global approach to our clients, and a much deeper organisational model on a local level on the property markets. It is our job to bring that capital to the local property markets and vice versa. Our objectives are to have a more diversified client base and a more local client base in Europe, to outperform the applicable benchmarks and to have hired the best people in the period to 2020.

We want to manage difficult situations into solutions. In 2020, we also would like to look back at growth, not only of the organic kind, but also gained through acquiring new business when needed and appropriate. Ultimately, we want to be the best investment manager in Europe, but not necessarily the biggest.

Deloitte: Before we conclude this interview, are there any other messages you would like to share?

Pieter Hendrikse

Yes, a very important one, in fact. Responsible investing and sustainability is going to be very, very important for real estate investments in the future. It is something that I think will fall under the spotlight of leadership or different stakeholders like pension funds, boardrooms, investment managers, property developers, traders, but also users.

The responsibility of using space on the planet is a truly high priority for all of us. I lead our internal global sustainability programme, in a way I am the leader of the CBRE Green Team. I have included sustainability targets and measurements in CBRE's investment strategies across the globe. This means that when we acquire a property, a sustainability check is an important part of our due diligence procedures.

Risk management in real estate
What keeps real estate managers up at night?

Dmitri Tsopanakos
Senior Manager
Audit Advisory
Deloitte

I read this in the paper the other day: *'Good Property Management should be supported by an efficient, Readily available Income base complemented by a Strong Knowledge Management Process'*. I think for a bit and I try it again, trying to read between the lines this time: *'Good Property Management should be supported by an efficient Risk Management Process'*. That's more like it.

Since the 1970s, TV series have been 'planting' hidden commercial messages in their scripts to capture the customer. Back then, regulation was light so statements like 'do you want a Coke or a Pepsi?' could easily slip into a script. Nowadays, the average consumer is smarter and may be too sophisticated to be interested in such a plain message process. Media businesses have found other ways to be successful in communicating such 'read between the lines' messages.

One way would be by introducing amazing new technology which is later made commercially available by one of their sponsors, using a sequence of images or words which directs the mind into thinking 'oh, I want some chocolate now', or 'I always wanted to go to Hawaii', etc.

Of course the question is: 'how all this is related to risk management in real estate?' Undoubtedly, the real estate industry has been one of the key drivers in the globalisation of capital over the past fifty years. The recent global recession, prompted by over-leveraging in many sectors including real estate, has resulted in increased focus on risk and stress across the real estate industry, and risk is now at the top of the agenda for owners, developers, managers, investors and, of course, regulators.

Stricter regulatory requirements, environmental and macro-economic exposure management, catastrophic modelling, data analytics and complex investor requirements (often involving financial institutions) are just some of the new era challenges facing the real estate industry. It is hard to escape the conclusion that the real estate investment landscape is undergoing rapid change.

Last year, we interviewed more than twenty stand-alone and embedded real estate fund and portfolio managers to get their views on the above. We conducted a series of brainstorming meetings, open forums and workshops in our Deloitte Analytics Labs and the result was quite astonishing as we see below:

This 'cloud-based' representation is quite simple and, at the same time, complicated in its meaning. Critically, the size of the font relates to the frequency with which each term arose. Does this frequency mean that this area is important for our client's business growth, cost base and risk exposure?

Is it regulatory or market driven? Does it provide insights into management decisions or does it hinder them? These are all questions that we challenged our teams in answering internally and in cooperation with our clients. The simple and most important question, however, remains the same - 'what keeps real estate managers up at night?'

If we look at the underlying analysis behind the cloud, as well as property level concerns such as tenant quality, lease breaks and exits, managers are now worried about their data, their risks and exposures, technology, the regulator, management and investor reporting, visualisation and outsourcing.

If we had these conversations five years ago, most of the latter would not even be in their agenda. An additional element to this is drive for change. Not appetite, but drive for change. Let us try to see why.

Why are real estate managers under pressure to change?

- **Information 'big bang'**
  Management, investor and risk-sensitive information is growing exponentially and has to be managed and reported
- **Regulation is coming in hordes**
  New regulation, varying across geographies, makes the ability to manage regulatory compliance requirements a high priority
- **Hyper-extended enterprise**
  Mobile employees, a complex and legacy system environment as well as a highly networked ecosystem make processes complex
- **Virtualisation**
  SaaS, Cloud and Cognitive computing, as well as the layers of outsourcing within property management and investment administration have led to many processes being outside the boundary and control of the organisation
- **Visualisation**
  Wide variety of internal and external stakeholders (managers, auditors, regulators, etc.) which require different information, greater visibility and better data accuracy in the organisations' risk and compliance state
- Internal Audit, **ERM (Enterprise Risk Management)** and Information Security are not designed to give a real-time dynamic view of an organisations' control state and risks
- The need to holistically manage common processes of the **data silos** that are already there and use old technology to manage the complex, diverse landscape of IT & Business

Managers are now worried about their data, their risks and exposures, technology, the regulator, management and investor reporting, visualisation and outsourcing

How does this impact the business? Why are managers happy they are still achieving their targets but so nervous about how they manage their business? How can they achieve their vision and strategy while, at the same time, ring-fence their operations against risks and modernise/transform their business with a robust, secure and efficient decision-making mechanism?

We have identified three areas in which real estate managers seem to be focusing their attention presently:

1. Investors

Investors are looking for increased understanding on risks and returns and want access to the right information, at the right time (which is inevitably earlier than before). They also want to be treated fairly, interact with a competitive manager and get quality information for their investments. Furthermore, the information needs to be available anywhere; on their monthly statement, on the web, their smart phone, their tablet/phablet and even on their wrist watch.

2. Risk management

Risk management has been an area of major focus for every real estate manager we talk to. The need for enterprise risk management of alternative investments, incorporation of risk analytics and better management of risk data which leads to optimisation of risk reporting, are only a few of the challenges Chief Risk Officers (CROs) are called upon to tackle in their daily business.

Technology plays a significant role in this as CROs need their risk teams to have access to better and more accurate risk information faster. If we also take into account that this information has to be retrieved from many sources across the business including old, legacy systems and manual information calculated on spreadsheets, then it is evident that providing their risk insight is now becoming a major challenge.

Liquidity and market risk will tend to have a greater effect on funds that are more growth-oriented, as the valuation of appreciated properties depends upon market data. Conversely, interest rate risk impacts the amount of distributable income that is paid by income-oriented funds. The challenge therefore becomes even more complicated to tackle.

3. Regulation

Regulation is a hot topic across every industry and sector. However, there have been a series of changes and introduction of new directives and rules which are reshaping the regulatory framework in the real estate industry: AIFMD and Solvency II (particularly for embedded managers) are only a couple of the new regulatory environments which incorporate a series of management and reporting requirements. These requirements affect nearly every part of the business from the front office, risk and compliance, finance and accounting, operations and even legal.

Regulators are asking for information to be reported in a more accurate and enhanced way, including more metrics, more information across the business and more detail. Again, technology is a key factor as reporting managers are struggling to get the information they need to report at the time they need it.

So, what can real estate portfolio managers do? How can they tackle these challenges? We do not aim to answer all these questions in this paper, but we have been working closely with real estate managers in helping them rationalise their data structures, applying analytics insights across their business and developing an optimised reporting framework, both internally to the board and externally to clients and the regulator.

There is a need for change and real estate managers are willing to embark on this journey. This is a journey that they need to invest in and effectively support and project manage to the end.

The competition is increasing, the investor demand is growing and so are the opportunities.

Wind of change

Towards a mainstream-like operating model for the real estate industry

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Regulations are shaping the real estate (RE) world. The industry and the alternative funds market in general are now caught in the regulatory spotlight and have not escaped tighter scrutiny and pressures for transparency from regulators and investors alike.

Following the global transformation of the retail fund industry in recent decades, new operating models spanning from the front-middle to back-office operations of RE asset and investment managers to service providers have emerged. These are not just necessary for adapting to current legal and industry guidelines but are key requirements for business viability, service marketability and expansion.

Major regulations that have pushed essential changes in the asset management industry include the Dodd-Frank Act and FATCA in the US, and the AIFMD and forthcoming PRIPS and BEPS OECD recommendations in Europe. Many of the RE structuring vehicles and investment strategies require compliance under this new wave of laws, directives and their implementation requirements. Investor and industry standard-setting bodies such as INREV are likewise influential in clamouring for industry reforms and standardisation of the highly fragmented, inadequately automated and vastly diversified RE business.

Moreover, the needs of investment managers are constantly changing, with some requiring more streamlined middle to back office, bridge financing, and a single point of contact for a cross-border and multi-jurisdictional service offering.

There is no doubt that IT infrastructure– composed of portfolio and risk management, planning or budgeting as well as accounting and administration systems – is at the heart of an asset management firm

An integrated approach is the way forward for asset, portfolio and risk management

The technology supporting asset and investment managers has changed drastically across the board in the last decade, offering holistic front to back solutions mostly for traditional and regulated funds. An increasing number of alternative asset classes are being supported, with geographic spread and specific local characteristics factored in, while emerging technological innovations such as advanced analytics, digital data extraction of paper contracts, predictive modelling and self-service business intelligence have reached a new level of maturity.

There is no doubt that IT infrastructure – composed of portfolio and risk management, planning or budgeting as well as accounting and administration systems – is at the heart of an investment management firm. RE players are facing an expanding set of challenges linked to these aspects, which are hard to handle without advanced technology. Beyond that, being able to quickly and effortlessly interact with business information is now considered essential to making the best business decisions in accordance with regulatory requirements.

The expanding variety of systems used brings additional issues for RE investment managers relating to the compatibility of data used to evaluate an investment and the common issue of differences linked to variations in calculation methodology. For example, marketing teams, accounting and risk departments can obtain different values for the same investment due to variation in their respective systems' parameters and a lack of integrated data.

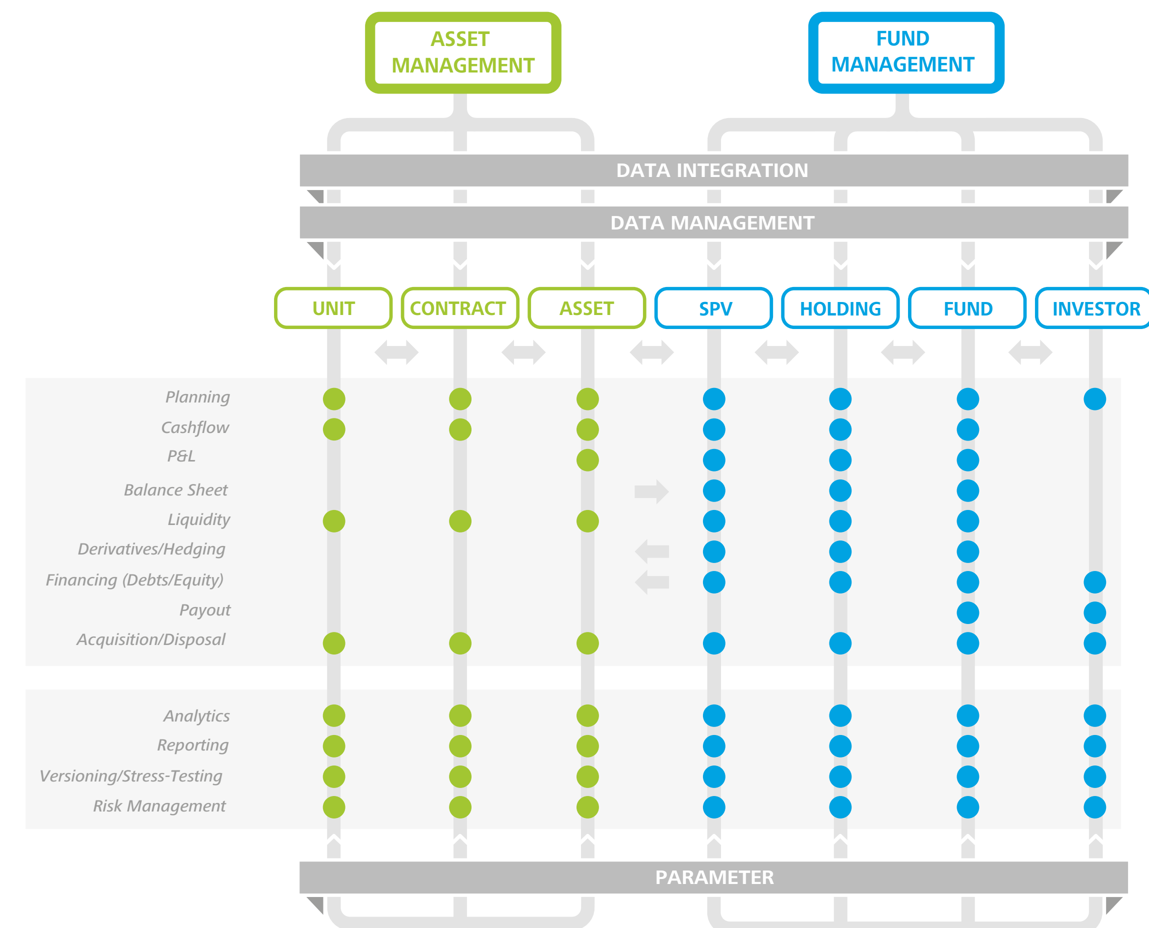
Such issues are clearly best handled by creating a centralised data warehouse able to serve as a control point for enhancing data quality and ensuring the enforcement of company and regulation standards. It also facilitates an organisation's ability to achieve a 'single version of the truth' across the company, while consolidating data from multiple, often heterogeneous and scattered sources.

A consolidated and unified view provided in a RE investment firm's reporting to its internal stakeholders, regulators, shareholders and clients is therefore key to reducing confusion and misinterpretation of data between the different parties. Many firms experience the negative effects caused by their systems' reporting shortfalls, which mainly relate to additional reconciliation workload, a lack of standardisation or missing capabilities for individual ad-hoc reporting. Reporting clarity is another important element, especially considering the multi-layered RE structures and their complex valuation methodology.

How to turn mountains of data into nuggets of insight

To compete with all the shifting challenges, a holistic and integrated view throughout all related professional domains is crucial and can be a game-changer in gaining a competitive advantage. In our experience, there are many stand-alone solution offerings that tackle separated domains or modules only (e.g. regulatory reporting, valuation, risk management, accounting or lease planning). This impacts productivity and accuracy, while users also suffer from restricted coverage of needed and crucial capabilities such as full consolidation at fund level in accordance with different local or international accounting rules, integrated look-through reporting or pervasive versioning due to a lack of flexibility of the system and staff.

Real estate investment management framework



Painting the big picture: integrated capabilities throughout all professional domains within the real estate investment management framework

In addition, clients are increasingly opting for online access to web portals for real-time or on-demand reporting on portfolios, cash flows, etc. Such reports are essential for investment managers to properly manage the portfolio, risk and liquidity of their investment funds in a timely manner. The ability of each provider to offer these business solutions using a robust platform is imperative not just for client retention but for business expansion as well, given that systems are one of the key selection criteria for asset managers when scouting for asset servicing partners.

Intensifying business competition along with extensive regulatory reporting requirements have been a challenge and an opportunity for both asset servicers and RE software vendors. Improved data quality and transparent and timely reporting are just a few of the many advances seen in the RE spectrum. With more persistent regulation, investor demands and changing best market practices, such improvements and challenges are not expected to abate anytime soon.

However, this competition is welcomed by market players as pivotal and necessary for the continued development and overall progress of the industry.

In conclusion

Uncertain times (worldwide trouble spots, currency risks, oil price under pressure, etc.) are resulting in steadily changing market environments and regulatory guidelines, while investor demands will increase in terms of increased standardisation, supervision and transparency on a cross-boarder basis.

The RE servicing industry seems to be moving towards operating models including competence centres set-up across the globe and unique IT solutions deployed in all operational centres — much like where UCITS fund servicers started decades ago.

In any case, the past evolution of technology standards now enables investment managers to obtain a comprehensive RE performance management solution for process-aligned planning and strategic portfolio steering taking advantage of predictive look-through capabilities, tracking actuals and with consolidated monitoring of performance, all spanning from rental unit to fund level.

Thus, appropriate utilisation and individual leverage of actual technology and software solutions enables investment firms and asset managers to opt for a comprehensive and scalable solution approach that exhausts given application standards and fully covers individual customisation needs (e.g. innosys[1]).

Additional key benefits are faster and tightly aligned budgeting processes, capacity savings in operational work, the provision of accurate, transparent and timely information and support in strategic decision making. In this regard, predictive analytics and what-if analysis help users to review and consider the impact of their potential decisions across all levels and working areas of the framework. Regarding the asset servicing value chain, one of the key requirements of asset managers is investor reporting.

Service provider systems must be able to handle specific investor reporting needs ranging from technical requirements (layouts, file formats and delivery either by post, email or web-access), to data content such as investment positions, performance data, fee and income allocation, and tax related information. However, in the RE industry this is still largely performed on a bespoke, tailor-made basis, as opposed to the more standardised investor reports for regulated retail funds such as UCITS. But with international standards such as INREV as well as pan-European regulations such as AIFMD and PRIPS, a more standardised reporting format will be achievable in the years to come.

RE asset servicers rising up to the challenge

With more RE firms either looking for outsourcing partners or wishing to limit costs while continuing to grow their business in the current business environment, the implications of new regulations and investor demands have cascaded down to service providers. This has triggered operating model changes, IT upgrades and business process optimisation projects to accommodate numerous and increasingly complex client requirements while at the same time managing operational risks.

While mainstream banks having entered RE asset class servicing over the last decade already underwent this kind of changing environment in the UCITS world over the last 15 years or so, pure RE asset servicers are facing these new challenges at a time of local and international growth. RE fund providers are aware that competition is intensifying. The range of core central administration (fund accounting, reporting and transfer agency) and custody (transaction processing, asset monitoring and reconciliations) services are generally uniform across all the main asset servicers, and with more demanding asset managers and investors, competition is now shifting towards specialised, value-added services, a global service offering spanning international target investment areas, fees and overall service quality.

A survey we recently conducted suggests that while core functions are generally performed in-house, most asset servicers prefer to outsource certain high-volume or repetitive tasks to central operating hubs or third parties. For fund administration services, 25% and 13% of respondents outsource fund accounting and reporting respectively, while for depositary services, 42% and 33% outsource reconciliations and transaction processing.

Opportunities and competition between service providers and technology providers

RE service providers recognise that having integrated, multi-functional, flexible and customisable systems is critical to meeting their business requirements, which are in turn aligned with client demands. These range from standard balance sheet, income statements and NAV reports to customised portfolio and risk analytics and supporting exception reports and escalations.

1 Innosys by Deloitte is a Real Estate Performance Management Solution and has a 14-years proven track record in providing comprehensive capabilities for integrated planning, flexible reporting, advanced analytics, risk and data management, while covering the entire life-cycle of investment assets and all of its aligned business processes.

From private placement to AIFM distribution

The new way to sell alternative investment funds

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After many intensive and controversial debates, the Alternative Investment Fund Managers Directive (AIFMD) finally became reality and entered into force on 21 July 2011. As one of the first member states, Luxembourg transposed the Directive into national law within the two year deadline in July 2013.

AIFMD provides the framework within the European market for the cross-border distribution of Alternative Investment Funds (AIFs). The key challenge is to understand the practicalities of how to comply with the Directive while continuing to raise capital.

General overview

In a nutshell, AIFMD regulates the access of Alternative Investment Fund Managers (AIFMs) to EU-domiciled investors. Contrary to the UCITS Directive, AIFMD does not regulate the product itself, i.e. the AIF, but the managers, the AIFM. Key objectives of AIFMD are to extend appropriate regulation and oversight to all alternative actors; to improve financial stability by monitoring systemic risk, to create a European market for alternative investments via passports for management and marketing activities and, perhaps most importantly, to increase transparency for the protection of the end investors.

The scope of AIFMD is far-reaching and applies to EU domiciled AIFMs (EU AIFMs) managing AIFs and non-EU domiciled AIFMs (non-EU AIFMs) managing and/or marketing AIFs within the European Union. AIFMD can be considered as encompassing AIFMs of all types of AIFs that are not covered by the UCITS Directive, thereby impacting private equity funds and hedge funds, real estate funds and retail non-UCITS funds marketed to any investors, be they professional or retail, and resident in the European Union. As ever, the Directive provides for some exemptions relating to specific thresholds and the exclusion of certain types of vehicles.

AIFMD offers new opportunities while at the same time bringing an array of challenges, certainly in the world of private equity and real estate having to transition from a relatively unregulated environment to a highly regulated framework within a few years. AIFMs are now not only subject to more scrutiny in areas such as authorisation, valuation, remuneration, liquidity and risk, but must also comply with operational rules, delegation and capital requirements, conduct of business rules as well as being subject to detailed reporting and investor disclosure requirements. The extent of these topics therefore touches almost all aspects of the alternative investment world.

One of the key aims of the Directive is to introduce a harmonised framework in terms of distribution. Since the end of the AIFMD transition period on 21 July 2014, 'private placement' in the pre-AIFMD sense of selling to EU-domiciled investors without informing the EU host state regulators of your intentions, is no longer possible. As of this date, all marketing and distribution activities can only take place subject to prior notification and approval of the relevant regulators.

AIFMD, like UCITS, has introduced the notion of a passport enabling AIFMs to offer their management services and market their AIFs to professional investors throughout the European Union. For the purposes of AIFMD, professional investors are those that are defined as professional clients under MiFID. Hence, marketing to retail clients is not governed by the rules of the EU marketing passport. Currently the passport is only open to EU AIFMs managing and marketing EU AIFs, but it is hoped that this passport may be extended towards the end of 2015 following ESMA's positive opinion. In the meantime, EU AIFMs wishing to market non-EU AIFs as well as non-EU AIFMs wishing to market either EU or non-EU AIFs within the European Union must comply with the National Placement Regimes (NPR). These NPRs are non-harmonised, vary in complexity depending on the 'gold plating' requirements imposed by the individual Member State Regulators and must be assessed on a case-by-case basis.

Since the end of the AIFMD transition period on 21 July 2014, 'private placement' in the pre-AIFMD sense of selling to EU-domiciled investors without informing the EU host state regulators of your intentions, is no longer possible

The EU marketing passport

The major benefits of the EU marketing passport are twofold in that firstly Member States are not officially permitted to 'gold-plate' the rules set down by AIFMD and secondly that the authorisation process is harmonised at EU level both in terms of documentation requirements and time to market.

For EU AIFMs, there are two distinct routes to follow when submitting notifications of intention to market AIFs on a cross-border basis to professional investors in the different Member States: Article 32 AIFMD for EU AIFMs wishing to market EU-domiciled AIFs in accordance with the EU marketing passport and Article 36 AIFMD for those EU AIFMs wishing to market non-EU domiciled AIFs. In both cases, the notifications must be submitted and relevant approvals received before any marketing and distribution activities may commence in the individual Member States. It is up to the EU AIFM to ensure it understands and complies with the local regulations in each Member State as to what constitutes permissive marketing and distribution activities.

For an Article 32 marketing passport notification, the EU AIFM must first submit a notification to its home state regulator in respect of each EU AIF that it intends to market. The notification comprises the documentation and information set out in Annex IV AIFMD. Once submitted, it is the responsibility of the home state regulator of the EU AIFM to transmit the filing(s) to the relevant host state regulators where the AIFM intends to market its EU AIF. As the home state regulator of the EU AIFM is the only point of contact for such filings, the EU AIFM does not need to communicate with the different host state regulators, thereby significantly simplifying the authorisation process.

Once the home state regulator of the EU AIFM has received the file, they have 20 working days to review and transmit the complete notification file to the host state regulator where it is intended that the EU AIF be marketed. Upon transmission of the notification file to the host state regulator, the home state regulator notifies the EU AIFM of the transmission date thereby allowing the EU AIFM to commence marketing activities in the relevant host Member State as of this date. If, however, the notification file is either incomplete or not compliant with AIFMD, the home state regulator reserves the right to reject the notification and to effectively restart the process.

In the event of a material change to any of the information or documents submitted with the initial Article 32 notification, the EU AIFM must inform its home state regulator at least one month in advance before the implementation of a planned change or immediately after the implementation of an unplanned change. If pursuant to a planned change, the EU AIFM's management of the EU AIF or the EU AIFM would no longer comply with AIFMD, the home state regulator will notify the EU AIFM without delay that the planned change cannot be implemented. The non-respect of these rules may result in the express prohibition of marketing of the EU AIF.

Although Member States are officially not allowed to impose stricter rules on EU AIFMs when marketing EU AIFs to professional investors, it is clear that some Member States have imposed 'gold-plating' requirements for EU AIFMs to market EU AIFs in their countries. France, for example, requires the appointment of a centralising agent based in France for all EU AIFMs which are not domiciled in France. Other Member States, such as Germany, France and Austria, require proof of payment of the initial notification fees to be included as part of the notification file.

Another point is that although Annex IV AIFMD states the requirements for the notification, several Member States have issued their own template notification letters, which although are in the spirit of Annex IV AIFMD, require differing levels of information. Some Member States require detailed information on the specific marketing arrangements that will be undertaken in their jurisdiction whereas others appear to accept more generic statements. Some notifications require the EU AIFM to sign the notification letter, others do not. Differences have also been noted in the treatment of filings by the Member State Regulators.

The UK FCA, for example, appears to have taken a stricter interpretation in that any 'gold-plating' information such as a proof of payment should not form part of the notification file and that it is up to the EU AIFM to communicate such information directly to the host state regulators. Others, for example the Luxembourg CSSF and Irish CBI, require that these 'local gold-plating requirements' form part of the notification files.

As ever, although AIFMD intended a harmonised passporting process, it is clear that small yet often significant details in the practical implementation make all the difference. Despite these variations, the process can be considered as relatively straightforward in comparison to the requirements of Article 36 notifications (EU AIFM with non-EU AIFM) and Article 42 notifications (non-EU AIFM marketing AIFs) under the national placement regimes.

The national placement regimes

Currently the marketing passport is only open to those AIFMs domiciled in the EU who manage EU AIFs. Hence, if an EU AIFM wishes to manage and market non-EU AIFs within the European Union, the EU AIFM must make separate applications (AIFMD Article 36 notifications) for each non-EU AIF to be marketed to the individual host state regulators. Similar individual applications will need to be made by non-EU AIFMs wishing to manage and market either EU or non-EU AIFs across Europe (AIFMD Article 42 notifications).

Unfortunately, contrary to the harmonised marketing passport, notifications made under AIFMD Articles 36 and 42, also known as National Placement Regimes (NPR), are driven by the (strict) rules of the individual Member States in which it is intended to market. These rules vary in complexity depending on the 'gold plating' requirements imposed by the individual Member State regulators. Each anticipated application must be assessed on a case-by-case basis in accordance with not only the local applicable rules in the targeted jurisdiction, but also the domicile of both the AIFM and the AIF.

For an AIFMD Article 36 notification, as the AIFM is EU domiciled, it is worth noting that Member States are free to decide if they allow EU AIFMs to market non-EU AIFs to professional investors via the NPR and whether to impose stricter rules than those laid down by the AIFMD. One exception relates to depositary requirements in that an EU AIFM marketing a non-EU AIF is able to apply a so-called 'depositary lite' regime in accordance with AIFMD Article 21.

For an AIFMD Article 42 notification, again it is up to the Member States to decide if they will permit non-EU AIFMs to access the NPR and they are fully entitled to impose stricter rules on the non-EU AIFMs in respect of marketing EU and/or non-EU AIFs in their territories. Although non-EU AIFMs are not fully subject to compliance with AIFMD, for the purposes of NPR notifications, the non-EU AIFM must fully comply with four key AIFMD requirements: Article 22 (submission of annual report), Article 23 (Disclosure to Investors), Article 24 (Reporting obligations to competent authorities) and as appropriate AIFMD Articles 26 to 30 (acquiring control of non-listed companies and issuers).

Successful NPR notifications are not only dependent on compliance with these Articles, but also have to be compliant with the local applicable rules in the targeted jurisdiction.

In practical terms, the AIFMD does not provide much guidance for NPR in terms of the content of the notification filing including 'gold-plating' requirements, timelines for approval of filings or how to notify host state regulators in terms of significant changes to the initial notifications. Our experience has shown that the NPR differs widely between jurisdictions. In Luxembourg and the UK for example, NPR notifications are generally approved within a few days of submission to the Luxembourg CSSF or the UK FCA. Other countries, including Belgium, Finland and Ireland, have not issued any guidance as to the timing. Denmark, for example, anticipates approval within three months but reserves the right to extend the period by an additional three months. Germany takes between two and eight months for approval depending on the domicile of the AIFM/AIF and whether master-feeder structures are in place. In almost all cases, the AIFM must await official approval of the Member State regulator before commencing any marketing activities.

When looking at the notification requirements themselves, some regulators have issued specific notification forms for NPR submissions, amongst others Denmark, Ireland, Luxembourg and United Kingdom. Some regulators require detailed notification filings with multiple documents, others are happy to receive a completed notification form with no requirement to include any documentation. Some regulators will accept electronic submissions, others require hard copy submissions.

The administrative burden faced by the AIFMs that are unable to access the passport is complex and that is even before entering into the detailed 'gold-plating' requirements. Focusing just on the depositary requirements in accordance with AIFMD Article 21, current indications are that for example Germany, Denmark and Ireland would permit a 'depositary lite' regime for both Article 36 and Article 42 notifications. Austria, on the other hand, would permit a 'depositary lite' regime for Article 36 notifications, but would require full compliance with Article 21 (depositary) for Article 42 notifications.

In addition to the local requirements for both NPR notifications, appropriate cooperation agreements for the purpose of systemic risk oversight and in line with international standards must also be in place between the competent authorities of the Member States where the AIFs are to be marketed and the supervisory authorities where the AIF/AIFM is domiciled or established. These agreements are established to ensure an efficient exchange of information between the various regulators. Another point to note is that the third country where the non-EU AIFM/AIF is established is not listed as a non-cooperative country and territory by the Financial Action Task Force.

Many articles in the media often mention the ongoing possibility of continuing to raise assets via so-called reverse solicitation or reverse enquiry. Although theoretically this may be conceivable, it should not be considered as a de facto strategy for raising capital in Europe as it requires real complexity in demonstrating the absence of marketing activities vis-à-vis the end investor. Again as is so often the case with AIFMD, regulators provide little or no clarity for such strategies and therefore they should only be considered having carried out extensive research on a case-by-case, jurisdiction-by-jurisdiction approach. What may work in one EU Member State may not work in another.

In conclusion, although the introduction of AIFMD brings with it an array of challenges, it is worth noting that ESMA recently published a consultation paper asking for feedback on whether the passporting regime should be extended to the management and/or marketing of AIFs by non-EU AIFMs and to the marketing of non-EU AIFs by EU AIFMs. We now await the issuance of ESMA's advice to the European Commission, anticipated by 22 July 2015, to see what happens next.

The real estate investment industry in the face of BEPS

Potential impacts, opportunities and threats

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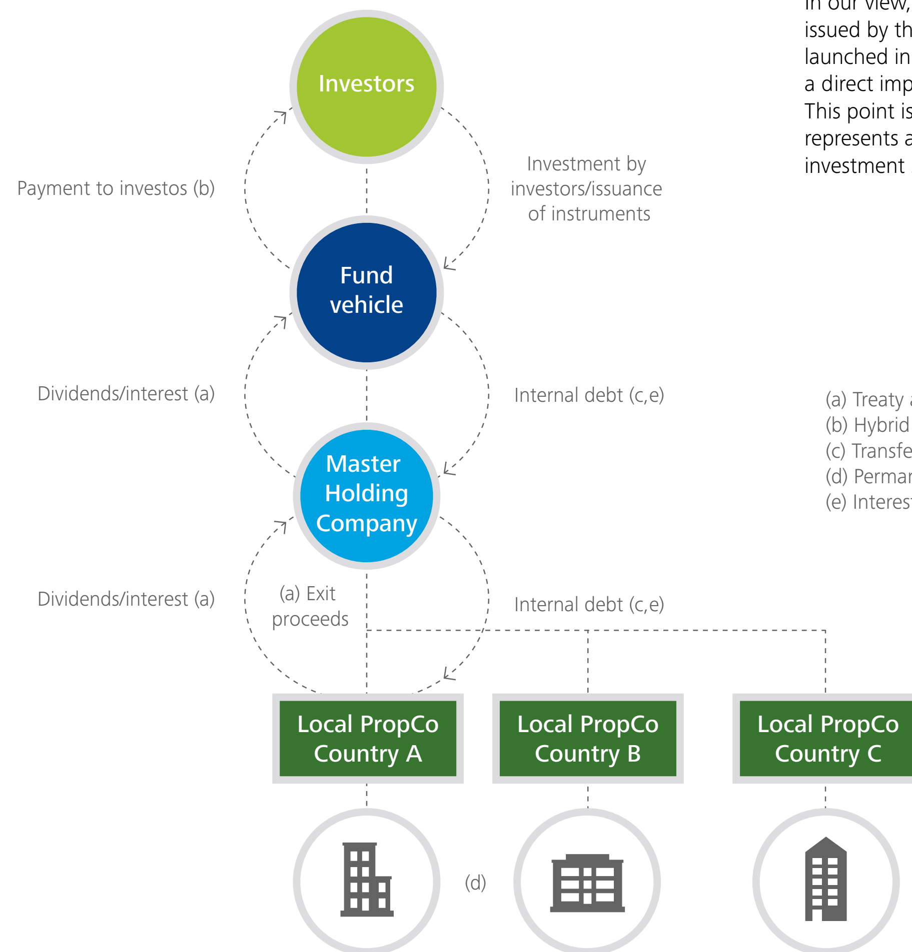
Innovation, new technologies such as the internet, and economic globalisation have changed the way corporates and investment funds operate and invest. International exchanges, investments and trades have grown significantly, creating new challenges for national tax authorities worldwide. Many consider that current international tax rules and approaches are no longer in tune with the realities of doing business in a globalised world and hence do not guarantee a non-discriminatory tax system.

In this context, on 19 July 2013, the OECD issued an action plan on 'Base Erosion and Profit Shifting' ('BEPS' and the 'Action Plan') describing 15 distinct initiatives or action points. The primary objective of this plan is to provide guidelines and actions to secure increased synergies between global economic integration, international cooperation and national taxation rights. Timing objectives centre on finalising recommendations by the end of 2015.

While it is true that the timetable of the BEPS project might seem over-ambitious, it has already prompted changes in approach from many national tax authorities and at EU level. For example, France implemented unilateral anti-hybrid measures by introducing specific legislation regarding disallowance of interest deduction on a loan granted by an affiliated company in some specific circumstances, while on 27 January 2015, an anti-abuse rule was formally inserted into the EU Parent-Subsidiary Directive.

Major market players anticipate that global direct commercial real estate transaction volumes could range between US$730 billion and US$750 billion in 2015



Major market players anticipate that global direct commercial real estate transaction volumes could range between US$730 billion and US$750 billion in 2015, making it the sixth consecutive year of volume growth, although the pace of economic recovery across the globe varies. In light of its strategic importance for the global economy, we will review whether the current BEPS proposals will have a negative impact on real estate investments and related sectors and whether there is a need to react.

Indeed, although real estate investments are not the main drivers of these new developments, upcoming changes in international tax standards, coordination and domestic tax legislation considered in the BEPS initiative might have an impact on the tax structuring and associated treatment of real estate investment structures.

In our view, based on available preliminary reports issued by the OECD, only a few actions (2, 4, 6 and 13) launched in the context of the BEPS initiative could have a direct impact on the real estate fund industry. This point is depicted in the chart below, which represents an example of a widely used real estate investment structure.

(a) Treaty abuse
(b) Hybrid mismatches
(c) Transfer pricing documentation
(d) Permanent establishment
(e) Interest deductions

This article will focus on Action 2 'Hybrid Mismatch Arrangements' and Action 6 'Preventing Treaty Abuse', which, as outlined above, may affect the way real estate investments are structured. We will address Action 4 of the BEPS Action Plan in a future issue of this magazine. Indeed, Action 4 focuses on drafting rules to prevent base erosion and profit shifting using interest and other financial payments economically equivalent to interest, and is therefore relevant for the real estate industry.

Each country generally applies its own set of rules and characteristics when analysing whether a financing instrument should qualify as debt or equity. This means that a mismatch whereby an instrument would be considered as debt in the master holding's jurisdictions (meaning tax deduction would be granted) and equity in the investors' jurisdictions (making income exempt from taxation of tax deferral) could arise in some cases. Such a mismatch may also be introduced via specific hybrid entities having different qualifications depending on their jurisdiction.

Action 2 of BEPS aims to neutralise the effects of such hybrid mismatch arrangements, either via certain types of entities or financial instruments, that could be used to achieve unintended double non-taxation and/or long-term (as opposed to reasonable) tax deferral. This Action[1] therefore calls for the development of model treaty provisions and recommendations regarding the drafting of domestic rules to neutralise the effect of hybrid instruments and entities.

The OECD has recommended several rules to be applied in the event that a hybrid mismatch arrangement is identified. The primary response should in most cases be that the borrower's jurisdiction denies the indirect tax deduction. In addition, the OECD's Action 2 set of rules also recommends that 'defensive' rule be adopted by the respective jurisdictions to be applied whenever a counterparty jurisdiction refuses to disallow a tax deduction in line with the primary response suggested.

The above could directly impact some of the standard structures and financing models currently being used. For example, nowadays, in the case of U.S. investors, it is common to see financing instruments qualifying as debt in the borrower jurisdiction and as equity from a U.S. tax perspective. This ensures that taxation for the U.S. investors is deferred until actual payment is made on the financing instrument by the borrower.

1 *See Action 2 – Neutralise the effects of hybrid mismatch arrangements (OECD, 2013a), pp. 15-16.*

This suggested OECD recommendation might therefore lead to a situation where the investors' jurisdiction would disregard its national tax rules for exemption or tax deferral and instead ensure that the revenue on the hybrid financial instrument concerned is taxed as ordinary income.

However, in this particular example, taxation for U.S. investors would only be deferred until actual payment on the financing instrument occurs. Although BEPS Action 2 includes an exclusion of the suggested new rules in the event that the mismatch is only due to a timing difference in recognition of the income and its taxation, the current report is unclear as to what could be considered as a reasonable timing difference. This point should be monitored once clarifications have been provided.

It is worth mentioning that hybrid mismatch arrangements are already rare within European real estate investment structures and that on 20 June 2014, ECOFIN adopted a proposal to amend the Parent-Subsidiary Directive in order to prevent the use of hybrid financing instruments. As a result of this amendment, the participation exemption may only be applied insofar as the payment is non-deductible in the country of payment, i.e. not tax deductible in the subsidiary.

Many consider that current international tax rules and approaches are no longer in tune with the realities of doing business in a globalised world and hence do not guarantee a non-discriminatory tax system

Another aspect to mention for the real estate industry in relation to Action 2 is directly linked to the definition of hybrid mismatch arrangements, which includes: "where that mismatch has the effect of lowering the aggregate tax burden of the parties to the arrangement". In most jurisdictions, investment funds are tax exempt, transparent or subject to very low taxation. However, payments to real estate funds should not fall within the scope of Action 2 since they do not reduce the overall tax burden of the investment structure.

In summary, real estate stakeholders should be aware that there is likely to be a requirement to identify hybrid entities, financial instruments or arrangements that lead to a mismatch in the tax outcome (i.e. deduction, non-inclusion or double deduction) and whether an exception could apply (e.g. timing differences). However, as described above, current changes in legislation in particular should mean that the impact on real estate structures should be limited and alternatives will be available.

Action 6 of the BEPS initiative – 'Preventing the Granting of Treaty Benefits in Inappropriate Circumstances' – could be of particular relevance for the real estate industry. Its main objectives are to limit access to the benefits of the treaty, notably via the insertion of a so-called 'Limitation Of Benefits' clause (LOB) and/or a 'Principal Purpose Test' (PPT) that would be introduced into all treaties either via a multinational agreement or via domestic law or renegotiation of treaties. The latter option may be impractical or time consuming. Insofar as the motive test is not met or the LOB applies, treaty benefits would be denied.

Given the specialised nature of real estate investments, it is common for investors to gain exposure to real estate assets via different types of Collective Investment Vehicles ('CIVs') collecting funds from investors resident in one or several jurisdictions (pension funds, family offices, SWFs, corporates, individuals, etc.). They invest these funds in assets located in distinct jurisdictions so as to diversify their investments e.g. by using different asset classes and geographical areas to ensure risk diversification.

One important concern of many real estate players and institutions therefore relates to the planned policy considerations regarding the treaty entitlement of CIVs. Indeed, while the proposed wording is not final, the suggested definition of CIVs (notably referring to the 2010 OECD report on CIVs) for the purposes of LOB provision is too narrow, as it would restrict treaty access for most European non-listed alternative CIV and non-CIV funds (including AIFs) as currently structured.

Therefore, since the publication of the OECD Public Discussion Draft 'Follow-up Work on BEPS Action 6: Preventing Treaty Abuse' dated 21 November 2014, many players in the real estate world have been lobbying to include CIV and non-CIV funds under 'qualified persons' as defined in the proposed LOB provision. This is a point to monitor going forward once final guidelines have been issued by the OECD.

Furthermore, specific investment and financing structures e.g. intermediary companies – Special Purpose Vehicles ('SPVs') are usually implemented to ensure that the tax burden of end investors is similar to the level of taxes that would have been paid had they invested in the real estate assets directly (i.e. funds must be tax neutral compared to direct investment). This is also the case for genuine financial, pro-business, operational and regulatory reasons.

Under the current LOB provision, an intermediary company would most likely only be entitled to the benefits of a tax treaty based on either the 'active trade or business' test or the 'derivative benefits' test. Some players are pushing for it to be included under 'qualified persons' or for the adoption of a milder LOB provision via a rather large and flexible 'derivative benefits' test. For the above reasons, the specific case of SPVs is clearly relevant for the real estate industry where, for example, application of a treaty might be important for capital gain taxation upon the sale of real estate investments via share deals.

Conclusion

As most of the recommendations are still draft versions and still being discussed, it is difficult to assess the actual impact that the BEPS initiative will have on the real estate industry. As it stands, only the recommendations in relation to Action 1 ('Digital Economy') of the BEPS initiative have been finalised and yet still do not reach firm conclusions and recommendations.

Based on the above and ongoing discussions, our view is that the impact should be limited, but real estate investment funds should also ensure they consider overall interactions between BEPS recommendations and other international or national actions such as CFC rules, GAAR, transfer pricing policies, etc.

Real estate investment funds should in particular ensure that important aspects such as substance, transfer pricing, risk management, changes in domestic tax laws and double tax treaty networks are monitored properly in light of their investment structures.

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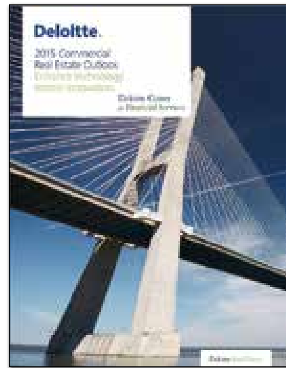
- Building consultancy
- Construction advice
- Cost consultancy
- Project management

6. Assurance

- Accounting and financial reporting
- Audit
- Environmental & sustainability reporting
- Financial due diligence and transaction support
- Governance, regulatory and risk
- Information and technology risk

Recent thought leadership

Interested in further reading on real estate? Take a look at Deloitte's recent thought leadership.



2015 Commercial real estate outlook:
Enhance technology. Enable innovation

In many ways, the commercial real estate (CRE) industry is on more solid footing than it has been for quite some time. The US economy continues to progress and investors are generally seeing robust performance across most property types and markets. Could 2015 be the year for growth for the industry?

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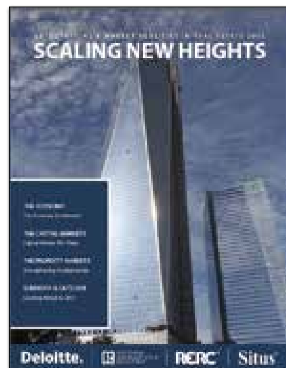

Expectations & market realities in real estate 2015:
Scaling New Heights

As 2015 gets underway, many investors are more optimistic than they have been in years. Economic growth has been increasing, job growth has been improving, and consumers have been given a boost as gasoline prices have dipped nationwide. Compared to the markets and financial systems in other developed countries, the U.S. economy looks generally healthy.

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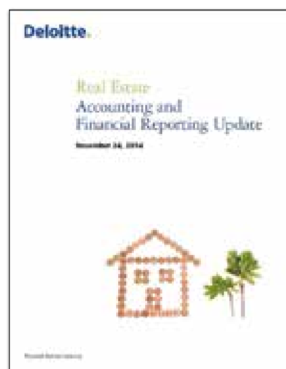

Real estate accounting and financial reporting update

The 2014 update highlights the year's accounting and reporting developments that apply to real estate entities. Topics discussed include (1) the issuance of new guidance on the recognition of revenue from contracts with customers and discontinued operations; (2) the continued work of the FASB on accounting for leases, consolidation, and financial instruments; and (3) the SEC's continued focus on rulemaking, particularly in connection with its efforts to complete mandated actions under the Dodd-Frank Act.

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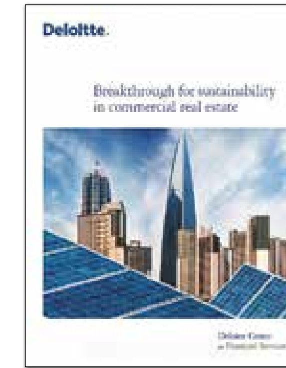

Breakthrough for sustainability in commercial real estate

The commercial real estate industry is at a crossroads. Industry players are posting average growth. Technology is changing the way in which real estate business is done. Client needs for physical space are also changing due to increased use of technology and enhanced environment consciousness, among other things. This in turn is changing the nature of demand for physical real estate space.

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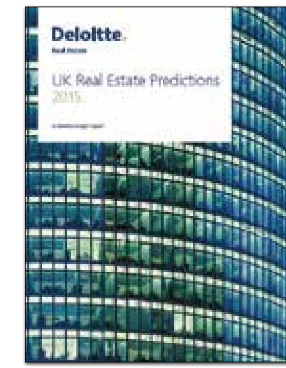

UK real estate predictions:
What will 2015 have in store for the UK?

Last year we highlighted the rise of Taiwanese investors, the fall in high street vacancy rates, and the growing importance of urban logistics – just some of the predictions that came true.

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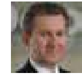

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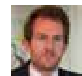

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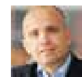

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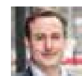

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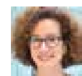

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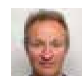

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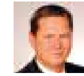

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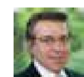

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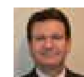

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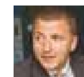

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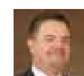

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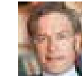

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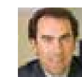

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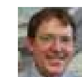

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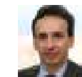

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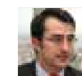

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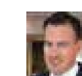

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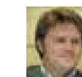

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