

REflexions

A Biannual digest for the real estate investment management industry | Issue 6 | EMEA | 2017

Interview:

Focus on real estate debt

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Foreword



Dear readers,

Diversification is the focus driving this sixth edition of REflexions. True to form, our magazine aims to provide readers with an insight into relevant tax and commercial issues the industry faces, as well as peering into markets outside the EMEA region, this time highlighting Australia. Moreover, we extend our focus to spotlight less traditional asset classes, such as infrastructure and real estate debt.

Alongside a growth in cross-border pension investment — globally and for the time being especially in Asia — the real estate debt market is on the rise. In an interview with Anthony Shayle, Head of Real Estate Debt EMEA within UBS Asset Management's Real Estate & Private Markets (REPM) business, we explore market trends, distressed debt and market regulation in the content of debt leveraging.

The industry continues to face key discussions in the wake of Brexit and the possible unravelling of the close inter-relationship of the city of London and European markets. Therefore, it is imperative to revisit this topic, shedding further light as the events unfold; this adds a real estate flavor to the considerations that are discussed in the broader investment management industry. Our Deloitte partners in the UK examine the consequences for investment managers in terms of their corporate structures and

taxation arrangements. Separately, we also look at the OECD Multilateral Instrument (MLI) and its impact on the practice of share deals, as it allows countries to change the allocation of taxation rights if shares in a real estate company are transferred.

To spice up this edition of our magazine, we gather the results of the latest Deloitte Property Index, this outlines the main trends in the European residential property market. Besides housing and transaction prices, this edition also focuses on the rental market, which plays an important role in the real estate industry.

Last but not least, we jump to the other side of the world, featuring a familiar topic to us and one of growing interest to the alternative investment management world: infrastructure. We interview QIC's Chief Executive Damien Frawley to understand his view on infrastructure assets in Australia and overseas, discovering why he thinks it is an investment with multiple benefits.

We believe that all of these subjects will continue to be debated over the coming weeks and months, but for now, we wish you an engaging read!

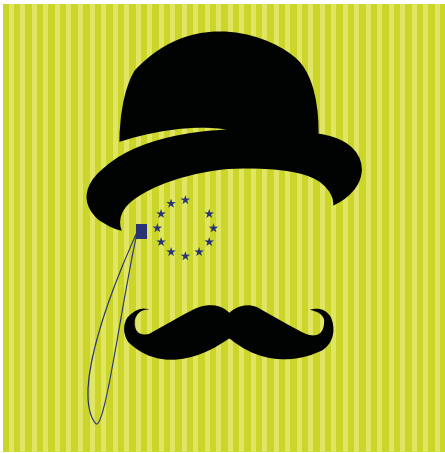
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Interview:
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Focus on real estate debt

Pierre Masset, Partner at Deloitte Luxembourg, interviewed Anthony Shayle, Head of Real Estate Debt EMEA within UBS Asset Management’s Real Estate & Private Markets (REPM) business, where they explored market trends, distressed debt and market regulation in the context of debt leveraging.



Anthony Shayle

With over 22 years of experience in real estate debt, as the Head of Real Estate Debt EMEA, Anthony Shayle is focused on growing the European real estate debt fund business within UBS Asset Management. Prior to joining UBS, Anthony held various senior investment, asset management, debt structuring, finance and accounting positions in the areas of private equity and real estate at Curzon Global Partners, AXA REIM, RODAMCO, BZW and Bankers Trust. Anthony is both a fellow of the Association of the Chartered Certified Accountants and the Royal Institution of Chartered Surveyors.

1. At various occasions in the last few years, we have talked about the “wall of money” coming into alternative investments. Could you please give us a sense of where the market is today, both in terms of supply and demand and how this “wall of money” affects the way in which investments are made?

This is a very interesting question because the so-called “wall of money” has, at varying times, been quantified differently and its source has shifted globally. So if we were to go back far enough, we could say that the money initially came from the US, then it came from the Middle East, and now it is coming from Asia. We could thus say that the “wall” is somewhat of a global tsunami moving around the world according to the wider economic cycle across our planet.

That said, where is the money coming from now? It is clearly coming from Asia at this moment in time. It is hard to go anywhere without seeing the mention of Korean, Chinese (which dominate today’s market), and more recently, Japanese money. This proves the substantial growth of these economies. In addition, what characterizes them is the fact that they are moving more and more into pension-planned economies. Therefore, this is a case of global demographics as much as it is about global economics. We also have to recognize that the investment industry, in which we are all working, is based around the source of the money coming out of varying types of institutional investment pockets. We could thus say that it is this demographic shift into pension fund-based economies that is fueling the so-called “wall of money”.

In terms of the supply and demand, we see a direct correlation between the volume of transactions in the real estate market and the opportunities for debt financing (if the first one falls, the second must, by definition, fall as well, because real estate transactions are predominantly leveraged). We have observed a trend shift from very highly-leveraged transactions pre-GFC (global financial crisis) to lower-leveraged ones.

To put that in context, the market has gone from 75–80 percent senior debt leverage, pre-GFC levels, down to 60–65 percent. This means that while there is still demand for debt, it may be marginally smaller. The debt market follows the trend of the investment transaction market – if the latter falls away, the former will follow suit. This implies that loans will run to term. This point is crucial because, as the market continues to grow, ➤

one would expect debt transactions to repay earlier than the stated maturity points. However, as the market turns over from growth to contraction, people who own real estate may choose not to sell it, which means they do not repay early, and consequently loans run to maturity. To this end, one of the key indicators for the state of the market is whether or not loan maturities are shorter than stated or are actually running to term. Of course, we are all so familiar with the consequences of loans running beyond term; we have seen that over the last 10 years. To sum up, one of the things to bear in mind is that the choice between an equity only investment and a leveraged equity investment (ie. with debt) is driving banking markets worldwide.

2. How does this change the way you allocate capital? On a day-to-day basis, as a fund manager, how does this change the way you look at things, given that we could potentially be near to a top-of-the-cycle moment?

Indeed, there is a high probability that you could be lending or investing at the top of the cycle. I think it is very difficult to judge the exact point at which the cycles will turn over. It is very evident that when you are close to the top of the cycle, you do change your investment strategy. Therefore, as early as 2013, we started raising a lending product linked to part of the upside on real estate. Our view as advised to our team,

as well as the investors coming into our fund, was not to focus on central London as a target for deploying capital. By doing so, we have carefully avoided substantial exposure to central London. Instead, the focus has been on a) anywhere outside of prime central London and b) alternative sectors that could offer the possibility to generate yield on the equity investment made, in other words, sectors where there is likely to be cap rate compression, and where there are prospects of further income growth.

3. In the debt space, in the last year we have seen a large portion of loans coming from banks' de-leveraging; where do you think we are in that process?

It is fair to say that the UK market has probably done most of the clearing out of distressed debt and non-performing loans (NPLs). Many people seem to be fond of NPLs now, but as a traditional lender, the preference is to originate debt with our own due diligence. Hence, from my perspective, the sooner the market is clear, the more likely you are to find stable lending opportunities. As mentioned previously, it is believed the UK has pretty much cleared itself. Spain has completed a large part of its work and Germany and France have clearly done theirs. There is one country remaining – Italy. This presents a great deal of opportunity though, as the

one thing that really matters in the NPL business is the ability to assume control of your asset. In my view, one of the things having held back the Italian market from international lenders is the enforceability of its charges and, in this respect, the NPL process in Italy must address this problem and find a solution to it.

4. Do you think a rising interest rate environment is likely to change the current picture when it comes to real estate debt?

This is an interesting question. No, it should not, but in practical terms, it can be. The issue is the cost of capital. So, in the case of rising interest rates, is the rise driven by central bank policy or by the risk push resulting from investor appetite? If it is caused by central bank policy, everybody's interest rate should be rising, and so investors should be on a level playing field. On the other hand, if it is caused by risk profiling, ie. investors taking a different perspective, then that creates opportunities in the market, and, ultimately, one person's risk is another person's opportunity.

5. Could you please share with us your views on leveraged debt funds?

This is a phenomenon that has been seen in the US and is now "coming to a theater near you". There is a very early indication that debt funds across Europe are now starting to look at leveraging themselves. Let's start with the basic principles. Is leverage a bad thing? A subsequent question would be, why put it there? There are two main reasons:

- The first one is that leverage may be used as a subscription line in order to manage draw-downs, in order to avoid taking huge chances with equity in the balance sheet and dragging down performance, which can be considered perfectly legitimate
- The second reason is to boost returns

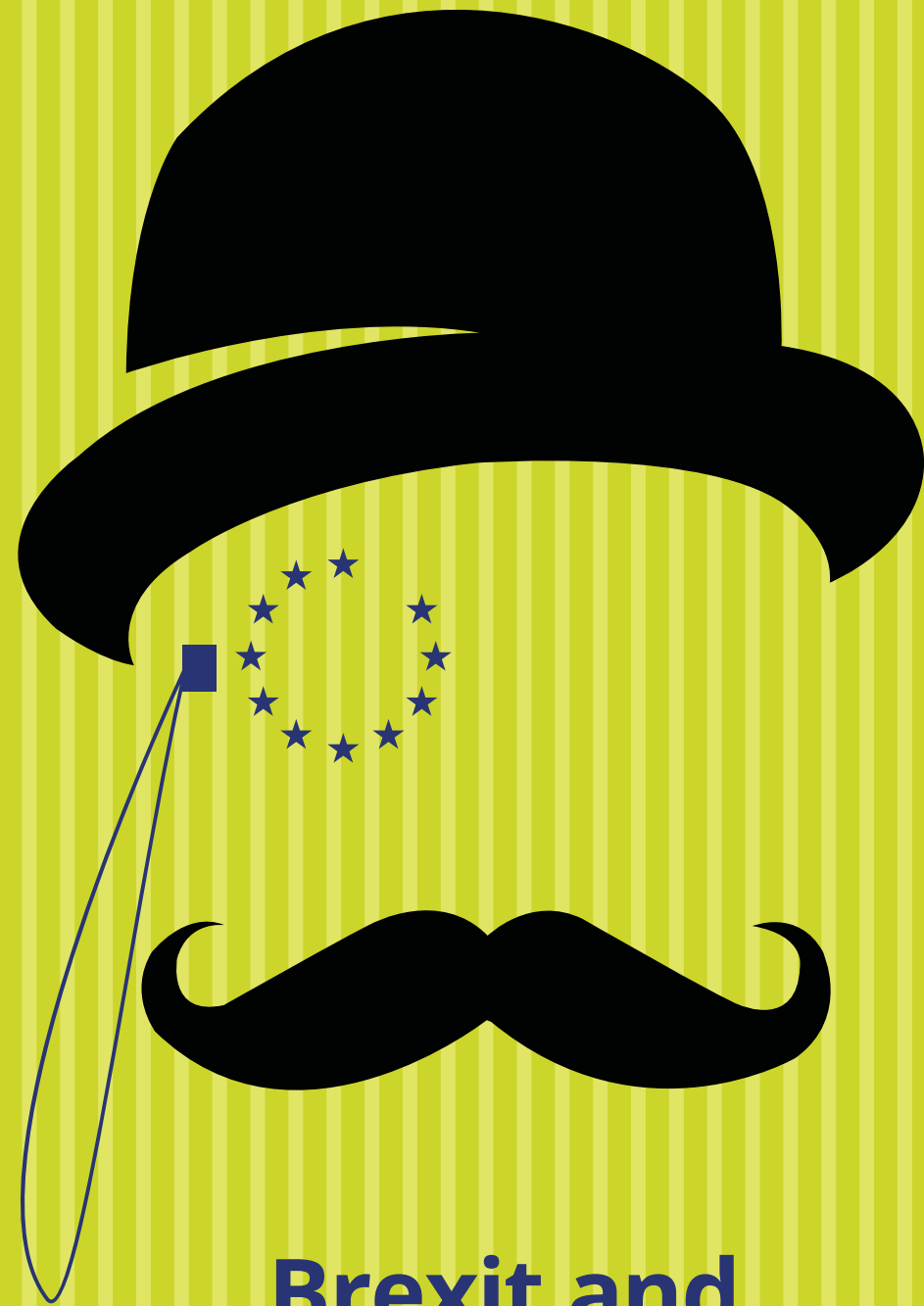
If we look back historically, 2013–2014 real estate lending returns were great; they were potentially outstripping traditional equity, which many investors became accustomed to seeing. Nevertheless, that could not last, and today the returns we see are much more constrained. Therefore, some fund managers find it perfectly legitimate to add some leverage to lift the return base, because investors seek superior levels of yield. It is of course perfectly fair to do that, but what everybody has to remember is that leverage brings volatility to equity level returns. So the question then becomes, would it be acceptable to leverage a debt fund? And the immediate reaction I always receive from investors is "no, you are not putting debt on debt". However, a distinction should be made between the debt taken on board (which is a liability in the balance sheet) and the debt leveraged upon debt (which is an asset in the balance sheet). To this end, leverage, in a debt fund, is not unlike that in a real estate fund. The only real difference is that for debt, it is leveraging contractual assets as such the related liabilities, interest rates and maturity exposures should be monitored and matched and, of course, the debt level should be kept within reasonable debt targets.

6. So you think that if we stay within those reasonable debt targets, regulation is not really required?

The more you leverage your debt portfolio, the more you look like a bank. Need I say more? ●

To sum up, one of the things to bear in mind is that the choice between an equity only investment and a leveraged equity investment (ie. with debt) is driving banking markets worldwide.





Brexit and the real estate market

A new tax operating model?

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Whilst speculation on the political process of Brexit is hard to avoid, the real estate market is primarily focused on the short-to-medium term effects on the UK economy, as the outcome of the negotiations, and to some extent the on-going uncertainty as to what the outcome will be, are impacting on investment decisions and the UK consumer. Any impact on both the ability to conduct the business of investing in real estate is currently a second order consideration, affecting only those who operate or invest via regulated vehicles, for whom the loss of passporting rights under EU financial services regulation may require an adjustment to their business model. For real estate investment managers, there has yet been little sign of a rush to relocate functions and individuals as many are waiting until the shape of any transition arrangements are clear; this is in contrast to banks and insurers who are already starting to enact their contingency plans.

We expect, however, that asset managers will start to move into a higher gear before the end of the year as they consider how to respond to the reality of the UK as a third country to the EU. For most in the alternative or private assets space, including real estate, the range of options as to where to domicile activities and people in a new regulated structure is quickly boiling down to a choice between Ireland and Luxembourg, with other jurisdictions only really entering the fray where there is a significant existing business there already.

Relocating significant business functions and management fee streams from the UK to another jurisdiction brings with it two major tax considerations—the one-off cost of transfer and the on-going impact of a firm's effective tax rate on its fee revenues.

For businesses in the sphere of investment management, most of these issues are similar across asset classes, and the article below is based on the recent analysis put forward in the last edition of Performance magazine, a Deloitte publication dedicated to IM. [➤](#)

Whilst legal and regulatory issues have tended to be front-of-mind to date, in practice it is likely that a combination of ESMA and the natural competitive tension between fund domicile jurisdictions will ensure that the scope for regulatory arbitrage between jurisdictions is limited. As a result, other issues, such as the impact on a group's tax profile, and the costs of staffing and running an office, will also be key to the decision.

Relocating significant business functions and management fee streams from the UK to another jurisdiction brings with it major tax considerations.

Brexit restructuring

The UK’s departure from the EU could have a significant impact on how UK-based asset managers operate within the single market.

The EU’s UCITS, MIFID, and AIFMD rules currently allow UK-regulated companies to passport across the EU. UK-based asset managers may currently rely on these passporting rights in order to distribute products in the EU, for example through EU branches, and manage EU-domiciled funds or segregated portfolios directly from the UK.

The precise impact of Brexit on these arrangements (and on so many things) is currently unclear, and it is likely to affect different managers in different ways. It will depend in particular on the types of product that are managed, the manager’s client base, and how the various EU directives are relied upon. Fund vehicles for pan-European exposure to direct real estate are domiciled in a variety of jurisdictions, often depending on source

of capital, but Luxembourg has been the increasingly common choice of managers as a venue for fund formation likely to appeal to the widest range of investors. This has not to date required the formation of a Luxembourg-based manager, however, and many such funds are managed under passporting rights from the UK.

There are also many managers, particularly those in the real estate private equity space who will continue to use a Delaware or English limited partnership model.

UK asset managers are less affected by Brexit than, for example, banks. However, it is likely that some will need to make important structural changes to continue operating across the EU, particularly if they are to continue to manage funds formed in Luxembourg. These changes are likely to include undertaking more activity through companies established in the EU, which we refer to as “EUco” in this article.

In practice, many of the larger institutional real estate investment managers already operate via AIFM-regulated management companies within the EU, many in Luxembourg. Even these, however, are likely to need to increase the size of their operations within the EU relative to the UK, not least in response to ESMA’s ongoing review of the level of delegation of responsibilities from EU managers to third countries.

The transfer of distribution and portfolio management activity from the UK to EUco could have a number of significant tax consequences. Key questions that managers need to consider include:

- Should tax have a bearing on where EUco is located?
- Will the transfer of branches or management agreements to EUco give rise to taxable disposals, or VAT-able supplies? If so, is relief available?
- What are the ongoing tax consequences of operating EUco?

In this article, we discuss some of the considerations that are pertinent to these questions.

Where to establish EUco

Legal and regulatory considerations, together with the location of existing operations, are likely to be the key drivers of where EUco is located. Nonetheless, the impact of the tax regime that applies to EUco should be assessed.

Corporate tax regimes

An obvious question is whether the activity that is transferred to EUco will be taxed at a different rate to the UK’s. The UK corporate tax rate is currently 19 percent, and will fall to 17 percent by 2020. These rates are significantly lower than the rates in many of the UK’s neighbors in continental Europe. Will performing distribution and portfolio management through EUco lead to significantly higher corporate tax liabilities? This is likely to depend on a few factors, including:

1. How much activity is transferred to EUco, and what profit the transferred activity generates. This in turn is likely to depend upon what EUco’s regulator will require in terms of substance and local presence (i.e., people “on the ground”), and the transfer pricing policies that are applied to EUco.
2. The treatment of any branches transferred to EUco. If EUco is in a jurisdiction that exempts branch profits from tax, those branch profits will only be taxed in the branch jurisdictions. There will be no additional tax on branch profits in EUco’s jurisdiction, and EUco will only pay tax on their “head office” profits.
3. Local tax rules, including what expenses can be deducted from taxable income and what tax incentives and allowances are available.

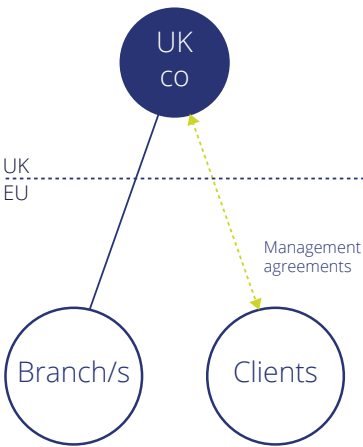
The UK’s departure from the EU could have a significant impact on how UK-based asset managers operate within the single market.

Of course, if EUco is based in jurisdictions with a lower tax rate than the UK’s, such as the Republic of Ireland, the new structure could generate tax benefits. However, anti-avoidance rules would need to be reviewed, such as the UK’s controlled foreign companies and diverted profits tax rules.

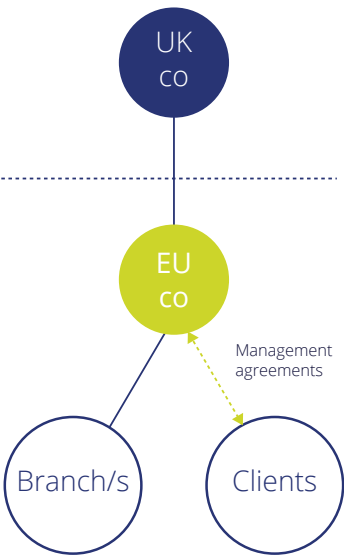
Repatriating profits

Currently, the EU parent and subsidiary directive can prevent withholding tax from being applied to dividends paid from an EU subsidiary to its EU parent. This means that a dividend received by a UK company from an EU subsidiary should currently be free from withholding tax. ➡

Current structure



Possible new structure



Once the UK leaves the EU, this withholding tax exemption may no longer apply, and UK companies may need to look to the UK's tax treaties for withholding tax relief. Not all tax treaties provide a full exemption from dividend withholding. For example, the UK-Germany tax treaty reduces the withholding tax rate to five percent, rather than zero. Therefore, unless the rules change or the tax treaty is renegotiated, transferring activity to a German company could lead to withholding tax leakage on dividends.

VAT rules

As with any structure that involves the cross-border provisions of services, VAT should be examined carefully. This is particularly important where EUco will be operating through branches. At the moment, charges between overseas branches and their head office are normally VAT-free. However, in response to the CJEU's Skandia judgement, many EU jurisdictions are changing their rules to impose VAT on certain transactions between a head office and its branches. Whether (and how) the judgement in Skandia will be adopted in EUco's jurisdictions could have a significant impact on the VAT treatment of any new structure.

Different jurisdictions also have different rules on how VAT exemptions are applied, when entities can form a "group" whose members do not need to charge VAT to one another, and the way in which input VAT can be recovered. They also have different rates of VAT. All of these factors will have an impact on VAT costs in a post-Brexit structure involving EUco.

It is worth remembering that VAT rules are governed by EU legislation. This means that, post-Brexit, the VAT landscape will change, adding an element of uncertainty to any assessment of how VAT will impact business operations in the future.

Transferring operations to EUco

Having decided where to establish EUco, the next key decision relates to how operations should be transferred to it. Tax is absolutely key to this decision-making process. This is because the transfer of assets from one company to another is normally a market value disposal for tax purposes, and possibly a supply for VAT purposes too. Where the assets are valuable, there is the risk of creating significant tax liabilities.

Fortunately, relief can mitigate these liabilities in many situations. However, complex conditions must often be met, and relief does not apply to every situation.

Transferring branches from the UK to EUco

The transfer of branches from a UK company to EUco can be complex, because two layers of tax need to be considered: one in the branch jurisdictions, and a second in the UK.

In the branch jurisdictions, relief may allow the branch assets to be transferred to EUco in a way that is neutral from a local corporate tax and VAT perspective. However, this will be subject to satisfying the local requirements. It may also be necessary, or advisable, to obtain a ruling from the local tax authority

Interestingly, in some EU jurisdictions, the relief permitting tax-neutral transfers could potentially be clawed back if the transferor ceases to be an EU company within a defined period after the transfer takes place. This means that, when the UK leaves the EU, taxable gains could potentially crystallize on previously transferred branch assets.

In the UK, companies can elect to treat overseas branch profits as exempt from UK corporation tax. Where this choice has been made, the transfer of branch assets to EUco should not be treated as a taxable disposal. While in principle this should make things simple, there are a few complexities to watch out for, including where an exempt branch has made tax losses and where there have previously been transfers of assets between the branch and its head office.

If a branch profit choice has not been made, the transfer of branch assets will be a disposal for UK tax purposes, although any UK tax liability can be reduced in proportion to the tax paid by the branch on the same gain. However, if relief applies at branch level, there may be no branch tax to "credit" against the UK liability. In this case, UK tax creates a cost.

Helpfully, there are special forms of relief that can defer or eliminate the UK tax that would otherwise arise on the transfer of branch assets to EUco. These relief systems are subject to a number of detailed conditions. One form of relief is also subject to a clearance procedure.

Some UK managers operate in the EU through representative offices rather than branches. Applying the rules and relief to the transfer of representative offices can cause difficulties that need to be worked through.

Transferring management agreements from the UK to EUco

The transfer of management agreements to EUco can also be problematic. A cross-border transfer of a UK asset, on the face of things, is a market value disposal by the UK management company, and potentially a VAT-able supply too.

Some managers may therefore consider terminating existing agreements and putting new agreements in place with EUco. If the existing agreements contain terms that permit such a termination, there is an argument that there has been no disposal of value, or supply. However, this approach does entail risk. The clients could choose not to appoint EUco, or could use the termination as an opportunity to renegotiate terms. It would also be necessary to consider whether the UK management company had played a role in EUco's appointment, which under transfer pricing principles should attract a reward.

Operating EUco

Any decision to relocate will naturally involve considering other specific needs relating to a manager's business, including that of supporting its funds' own holding companies via local managers and support staff. For real estate, headcount is becoming increasingly significant owing to the need to evidence economic substance and non-tax reasons for placing a holding company in a given jurisdiction.

The cost synergies of establishing a regulated management business alongside an existing operating and holding company platform in, say, Luxembourg, may carry significant weight, with the ability to share floor space and support staff constituting a key benefit. There is as yet, however, no certainty that tax authorities in the jurisdictions where a fund invests will give too much weight to the location of a fund's manager in considering the entirely separate question of whether to grant treaty benefits to a holding company.

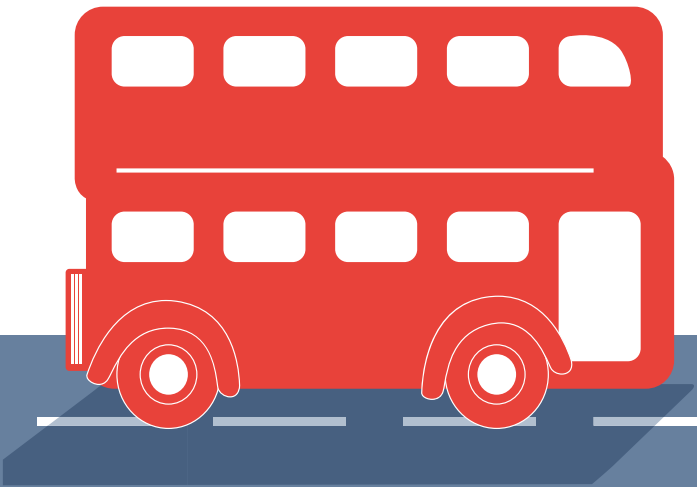
Once EUco have been established and activity has been transferred to them, the focus will be on operating them as efficiently as possible. Ideally, these operational considerations should have been assessed as part of the jurisdiction selection process.

As noted previously, key issues are likely to include VAT leakage arising on cross-border charges, exposure to different rates of corporate tax, and the risk of withholding tax on profit repatriation.

Where staff need to be relocated or will be travelling between the UK and EUco's jurisdictions, managers will need to have policies and frameworks in place to meet business requirements and also comply with the applicable tax, social security, and immigration rules.

Managers will also need to consider strategies for rewarding and incentivizing EUco staff. They will need to understand the local regulatory requirements on remuneration, how to structure local pension arrangements, as well as legal issues pertinent to participation in global incentive plans, the transfer of employee data, and employment rights.

The more practical day-to-day consequences of operating EUco (e.g., tax registrations, filings, and other compliance obligations) should not be overlooked either. ●



1 A representative office is an operation which does not create a taxable presence, or "permanent establishment" in its local jurisdiction

Deloitte Property Index 2017

How Europeans live and what it costs them

Is renting a dwelling a profitable investment?

Petr Hana

Senior manager
Deloitte

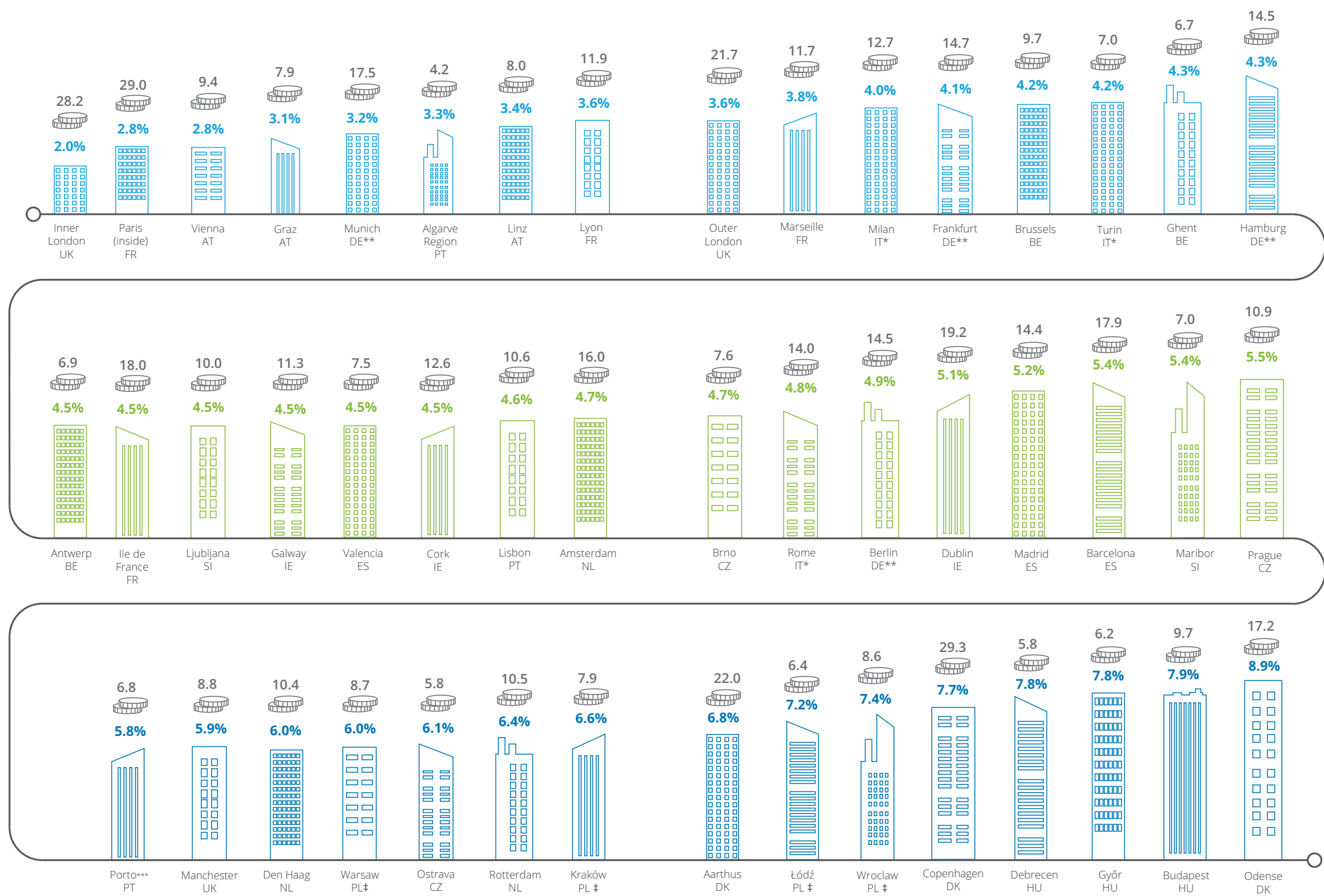
Vojtech Petrik

Consultant
Deloitte

Apartment rental yields in European cities ranges between 2 percent and 9 percent. At the same time, the highest transaction price growth in 2016 was surprisingly recorded in Slovenia. The most expensive city remained inner London. These are selected results of the most recent Deloitte Property Index, which compares the market with residential properties in selected European countries and cities and in Israel. ▶

The sixth edition of Deloitte Property Index study focused on the rental market for the first time in its history. Rental housing is the most popular among Germans (54.3 percent of total number of households) or Danes (46.6 percent) and the least among Slovenians (2.4 percent). These figures show that the rental market plays an important role in the real estate business recently. Anyone considering buying an investment property (also known as buy to let method) will be interested in what return the property will give him or her, in other words, its yield. Deloitte Property Index therefore dealt with the comparison of average rent level and transaction price of a dwelling. The lowest yield from rent in all of the compared cities was recorded in central London (2.0 percent), followed by inside Paris (2.8 percent) and the highest in Odense, Denmark (8.9 percent) followed by Budapest, the Capital of Hungary (7.9 percent). From another perspective, Copenhagen was the place with the highest monthly rent (€29.30 per square meter). On the other hand, the lowest rent level has been seen in Algarve Region in Portugal (€4.20 per square meter).

Focus: Rental market
Is renting a dwelling a profitable investment?



Average monthly rent per square meter in EUR

%
Annual rental yield

2 - 4.3%

4.4 - 5.5%

5.6 - 8.9%

*Older dwellings
**Bid price
***New and older dwellings
‡ Net yield

Source: National Statistical Authorities, Deloitte data calculations.

According to housing development intensity, the volume reached 2.8 completed apartments and 3.7 initiated apartments per 1,000 citizens across the European Union in 2016. The greatest development intensity of all selected countries was seen in France (6.8 completed dwellings per 1,000 citizens). This country also recorded the highest total number of completed dwellings reaching 453 thousand. In terms of initiated dwellings the highest intensity in 2016 was found in Austria (7.6 started dwellings per 1,000 citizens), Israel (6.1), and France (5.7).

The structure and quality of the housing stock can generally be considered as one of the indicators of quality of life and regional development. The average housing stock in the European Union in 2016 remained at 486.6 apartments per 1,000 citizens. In total numbers, this represents 245.6 million dwellings. More than 1.2 million dwellings have been added based on year-to-year comparison. Similarly to 2014 and 2015 in a comparison of selected countries, Portugal reported the greatest housing stock recalculated per 1,000 citizens, exceeding the European average by more than 15 percent. The lowest housing stocks in 2016 per 1,000 citizen was found again in Israel (295 dwellings) and Poland (372 dwellings).

Average transaction price of the new dwelling (EUR/square meters), 2016
Annual change (%)

















- <0%
- 0% - 5%
- 5% - 10%
- 10% - 15%
- 15% <

*Older dwellings
**Bid price
***New and older dwellings

Source: National Statistical Authorities, Deloitte data calculations.

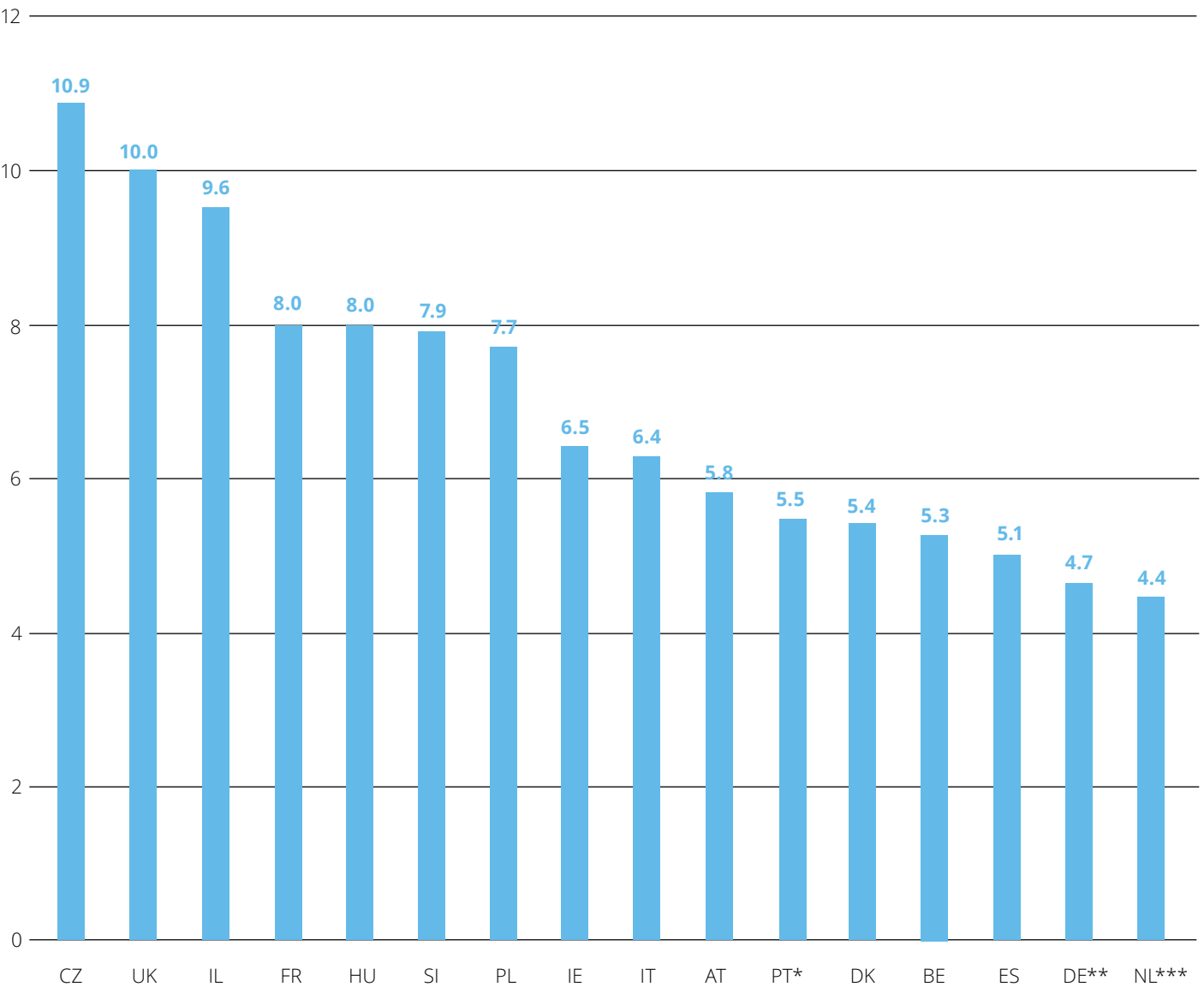


Average transaction price of a new dwelling (EUR/square meters) and 2016/ 2015 change

| | | | | |
|-------|-------------------------------------------------------------------------------------|----------------|--------|--------------------|
| AT |  | Vienna | 1.8% | <div></div> 3,999 |
| | | Graz | 1.3% | <div></div> 3,063 |
| | | Linz | 1.9% | <div></div> 2,842 |
| BE |  | Brussels | 2.7% | <div></div> 3,096 |
| | | Antwerp | 0.5% | <div></div> 2,925 |
| | | Ghent | -3.2% | <div></div> 2,777 |
| CZ |  | Prague | 10.5% | <div></div> 2,368 |
| | | Brno | 15.2% | <div></div> 1,939 |
| | | Ostrava | -3.2% | <div></div> 1,149 |
| DE** |  | Berlin | 9.7% | <div></div> 3,510 |
| | | Hamburg | 6.1% | <div></div> 4,020 |
| | | Munich | 8.2% | <div></div> 6,580 |
| | | Frankfurt | 8.9% | <div></div> 4,300 |
| DK |  | Copenhagen | NA | <div></div> 4,582 |
| | | Aarhus | NA | <div></div> 3,918 |
| | | Odense | NA | <div></div> 2,327 |
| EE** | | Tallinn | 0.0% | <div></div> 2,340 |
| ES |  | Madrid | 4.0% | <div></div> 3,353 |
| | | Barcelona | 6.0% | <div></div> 4,008 |
| | | Valencia | 4.3% | <div></div> 1,982 |
| FR |  | Paris (inside) | 15.6% | <div></div> 12,374 |
| | | Lyon | 5.0% | <div></div> 4,015 |
| | | Marseille | -2.0% | <div></div> 3,700 |
| | | Ile de France | 2.2% | <div></div> 4,838 |
| HU |  | Budapest | 15.3% | <div></div> 1,480 |
| | | Debrecen | 11.2% | <div></div> 883 |
| | | Győr | -0.5% | <div></div> 947 |
| IE |  | Dublin | 6.5% | <div></div> 4,519 |
| | | Cork | 12.6% | <div></div> 3,324 |
| | | Galway | 9.0% | <div></div> 2,998 |
| IL |  | Tel- Aviv | 16.6% | <div></div> 8,168 |
| | | Jerusalem | 2.4% | <div></div> 5,202 |
| | | Haifa | 21.3% | <div></div> 3,884 |
| IT |  | Milan | 0.0% | <div></div> 3,613 |
| | | Rome | -1.7% | <div></div> 3,409 |
| | | Turin | -2.0% | <div></div> 1,992 |
| LT** | | Vilnius | 7.6% | <div></div> 1,775 |
| LV** | | Riga | NA | <div></div> 1,810 |
| NL*** |  | Amsterdam | 11.9% | <div></div> 4,081 |
| | | The Hague | 6.6% | <div></div> 2,089 |
| | | Rotterdam | 9.5% | <div></div> 1,963 |
| PL |  | Warsaw | -1.5% | <div></div> 1,729 |
| | | Krakow | 0.0% | <div></div> 1,432 |
| | | Łódź | -2.0% | <div></div> 1,071 |
| | | Wrocław | -2.4% | <div></div> 1,387 |
| PT |  | Lisbon | NA% | <div></div> 2,572 |
| | | Porto*** | NA% | <div></div> 1,407 |
| | | Algarve Region | NA% | <div></div> 1,514 |
| SI |  | Ljubljana | 6.4% | <div></div> 2,660 |
| | | Maribor | 0.0% | <div></div> 1,550 |
| UK |  | Inner London | -8.8% | <div></div> |
| | | Outer London | -16.7% | <div></div> 7,145 |
| | | Manchester | NA | <div></div> 3,035 |
| | | | | 16,538 |

In order to assess the affordability of one's own housing, Deloitte Property Index measured how many average gross annual salaries it takes to buy a standardized new dwelling (70 square meters). For the first time in the history of the Index, affording new housing is the most difficult for Czech citizens, as the cost of an average apartment is equal to 10.9 average gross annual salaries, almost one whole annual salary more than the British, who ranked second. In opposite the most affordable housing can be found newly in the Netherlands, where a person needs to on average save only 4.4 years to buy a new dwelling.

Affordability of own housing
Average gross annual salaries it takes to buy a standardized new dwelling (70 square meters), 2016

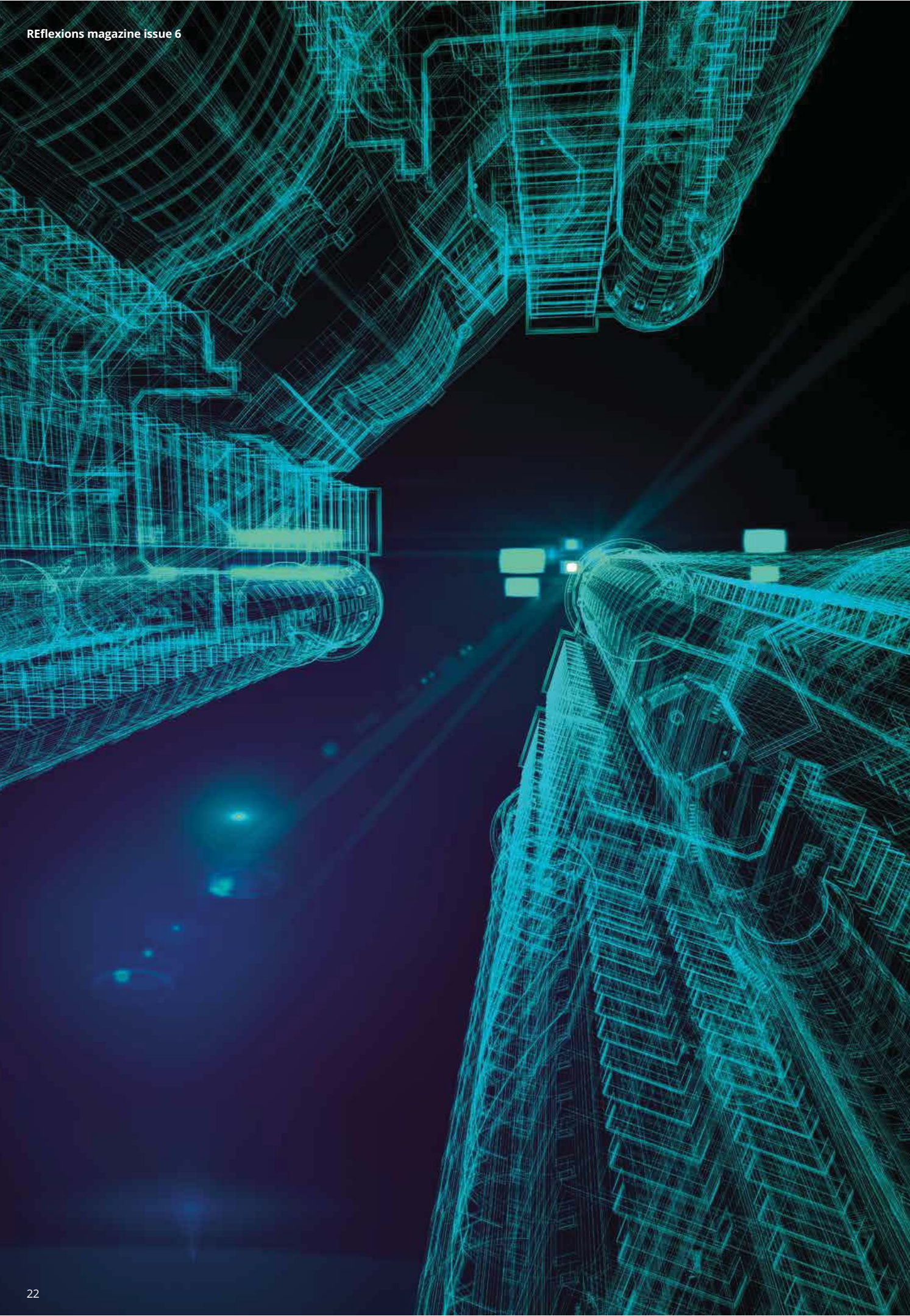


% Average transaction price of the new dwelling – Annual change (%)

■ Average transaction price of a new dwelling

*Older dwellings
**Bid price
***New and older dwellings

Source: National Statistical Authorities, Deloitte data calculations.



The study also covered another important indicator on the residential market, indebtedness of the housing stock, i.e. the proportion of the volume of mortgage loans to household disposable income. The lowest level of indebtedness among all surveying countries was found in Slovenia with 23.8 percent of residential debt to household disposable income. On the other hand, Netherlands, Denmark and United Kingdom had residential debt to household disposable income above 100 percent.

Almost all developed countries are in recent years facing low interest rates environment, which in fact heavily influences the residential market. Therefore, mortgage rates are still moving at the lowest levels. Czech Republic was found to be the place where you could get a mortgage with most favorable conditions of bank financing in 2016. The average mortgage rate fluctuated around 1.77 percent. In contrast, undoubtedly the least affordable mortgage financing was recorded in Hungary with an average interest rate of 6.5 percent. ●

The structure and quality of the housing stock can generally be considered as one of the indicators of quality of life and regional development.



The MLI and the share deal

Henk de Graaf

Partner
Tax
Deloitte

The share deal. In some markets it is the “benchmark” for transferring individual real estate assets. During a Hay Day in the real estate markets entire real estate portfolios tend to be transferred in the form of share deals. Could this practice be impacted by the OECD Multilateral Instrument (the “MLI”)? After all, under the MLI countries could change the allocation of taxing rights if shares in a “real estate company” are transferred. In this article we take a closer look at the relevant parts of the MLI and whether it could indeed impact share deals. ➔

What is this MLI?

So what exactly is this MLI? The MLI is an instrument deployed by the OECD for amending a multitude of bilateral tax treaties in “one go”. Following the Base Erosion and Profit Shifting (“BEPS”) reports of the OECD, certain changes must be made to bilateral treaties to avoid unwanted use of such treaties. For instance a minimum standard anti-abuse rule is to be included in each existing treaty. Since a tax treaty is an agreement between two sovereign states, changing a treaty would in principle requiring these two states to start bilateral discussions and agree to the change of the specific treaty. With 71 jurisdictions being part of the BEPS initiative, this process would require one-on-one renegotiation of over 1,100 tax treaties. To avoid this unworkable process the MLI is created to amend all relevant tax treaties simply by each country signing the MLI. This is based on the principle of countries electing for certain adjustments. In broad terms, if matching selections are made, changes to the double tax treaty are made under the MLI.

The MLI is an instrument deployed by the OECD for amending a multitude of bilateral tax treaties in “one go”.

Why share deals for transferring real estate?

Before going further, let us first define what a share deal basically is. A share deal can be described as the indirect transfer of the ownership of immovable property by transferring shares or other rights in an entity. Such entity would directly or indirectly – through ownership of underlying entities – own immovable property. There can be a variety of reasons for structuring a real estate transaction as a share deal.

Where the direct transfer of an asset deal is commonly taxed with real estate transfer tax or stamp duty, certain countries (like Belgium) do not tax the acquisition of shares in an entity owning real estate. As a result, transfer taxes can be saved by transferring shares, instead of the property itself. In addition, the taxable basis (like France) or applicable tax rate for acquiring shares in a real estate company could be lower when compared to an asset transfer, providing for a financial benefit.

One other important benefit of a share deal is that sales proceeds could be higher when selling shares.

For portfolio sales, a share deal is most preferred from a practical perspective. Transferring an existing structure often is considered easier than transferring each individual asset. Additional benefits include that if properties located in different countries are transferred, transfer taxes could be reduced since certain thresholds for taxation (i.e. the portfolio consists for 30 percent or more of Dutch assets) are not met.

One other important benefit of a share deal is that sales proceeds could be higher when selling shares. If a property is disposed directly, any taxable capital gain – the difference between the sales price and tax book value – in most countries is taxed at statutory rates. So, assuming a capital gain of 10 million and a tax rate of 25 percent, 2,5 million in tax will have to be paid in the year of sale. If shares in a property company are transferred, the inherent / latent capital gains tax included in the entity is also 2,5 million. After all, the tax authorities will ultimately be taxing the gain. However, if the shares in the entity are transferred the latent gain is not triggered for tax purposes, so no immediate cash outflow of 2,5 million. Rather the value of the shares is reduced by the amount of tax on the latent gain. If the prospective buyer does not plan to transfer the property, the tax on the gain will be deferred. When the time value of money is taken into account and following commercial negotiations, the market could value the deferred tax liability of 2,5 million at – say – 40 percent of its nominal value; 1,0 million. As a result, for a share deal the net cash sales proceeds are 1,5 million higher when compared to an asset deal.

But what about the taxation of the gain on the disposal of shares? After all, higher sales proceeds are only realized provided the entity disposing the shares is not taxed. If this entity is either taxed in its country of residence or in the country of residence of the subsidiary, a large part, or even the entire benefit, could be taken away.

This is where a double tax treaty comes into play. If we take the example (see figure 1) in the picture, we see an entity in Country A owning shares in an entity in Country B. The only asset of the latter entity is real estate located in Country B. Certain current tax treaties stipulate that in the example only Country A is allowed to tax the gain on the disposal of shares. Other tax treaties however contain a so called “real estate company”-clause. Under such clause, in broad terms, taxing rights on disposal of shares in entities the assets of which for a certain percentage consist of real estate “B” are allocated to Country B. Such treaties include a clause that could read (OECD standard): “Gains derived by a resident of Country A from the alienation of shares deriving more than 50 percent of their value directly or indirectly from immovable property situated in Country B may be taxed in Country B.” Note that it is the aim and purpose of the tax treaty to avoid that Countries A and B would both be taxing the same profit. Hence the treaty aims to avoid double taxation. Where the tax treaty arranges for allocation of taxing rights, the national laws of Country A and B will determine whether tax is actually levied, or not. ➡

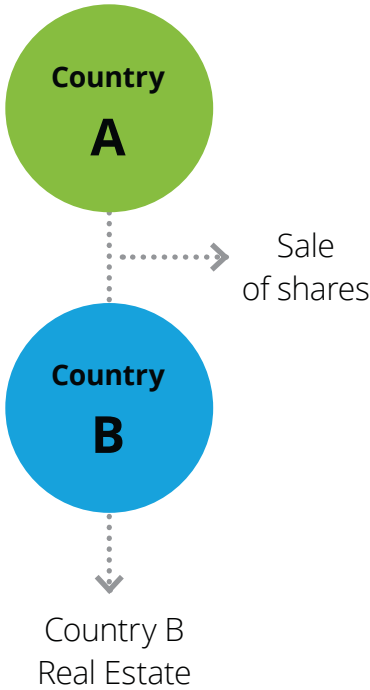


Figure 1: Example double tax treaty 1

If taxing rights are allocated to Country A, and Country A is the Netherlands or Luxembourg, the gain is likely to be exempt under their domestic laws. These countries and some others generally exempt gains from share disposals from tax under their participation exemption regimes. Such regimes aim at avoiding double taxation of the same profit, hence the exemption. Other countries, however, may simply tax the gain or provide for a certain level of credit for the underlying tax in Country B against the tax due in Country A.

What needs to be considered is that even if taxing rights are allocated to Country B, certain countries do not have the ability to actually tax the Country A entity under their domestic laws (see figure 2). The domestic laws of certain countries simply do provide for the possibility to levy country B tax from the Country A entity. If the entity owning the real estate is resident in a third country, the situation becomes even more complicated. We for instance

could have an entity in Country A, owning the shares in an entity in Country C, owning real estate in Country B. For countries “B” to be able tax gains on the disposal of shares in the Country C entity, its domestic law should allow for an extra territorial levy of tax. From a conceptual perspective extra territorial levy of tax is not straightforward. So a situation could occur that domestic laws would allow taxation of the Country A entity in the first example, but would not allow taxing the Country A entity for gains on disposal of shares in the entity in Country C.

In order to avoid double taxation and to maximize returns for their investors, many real estate funds currently have set up structures in which capital gains on disposal of shares in real estate companies are not taxed or are exempt in both Countries A and B. This leaves the way open for a tax efficient exit of an asset via a share deal. Obviously, the deferred tax liability on the inherent gain is not reduced as a result of this structuring.

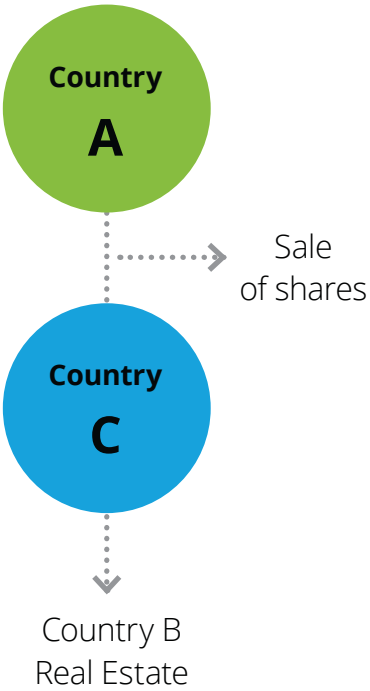


Figure 2: Example double tax treaty 2

Transferring an existing structure often is considered easier than transferring each individual asset.

Could the MLI change the allocation of taxing rights?

In principle, yes. The MLI provides countries with different options in respect of the taxation gains on disposal of shares in a real estate entity. When looking at the MLI, it provides for the following possible amendments to existing treaties:

- 1. Introduce a real estate company article in treaties that currently do not include such article;
- 2. Introduce a clause stating that the article shall apply if the relevant value threshold is met at any time during the 365 days preceding the alienation. The value threshold is the minimum percentage of real estate a company directly or indirectly owns, generally set at 50 percent. So the percentage Country B real estate in the example.
- 3. Introduce a clause stating that the article shall apply not only to shares in entities, but also to “comparable interests”, such as interests in a partnership or trust (to the extent that such shares or interests are not already covered).

Amendments 2 and 3 are more of an anti-abuse nature. The 365 day timeframe aims at avoiding that changes to the composition of the balance sheet shortly before an alienation of shares bring the percentage real estate below the applicable threshold. The gain then could not be taxed in Country B at the moment of alienation. Amendment 3 widens the range of entities to which the article applies. It aims to avoid that the article would not apply if interests in a partnership or trust type entity owning the real estate instead of – say – a limited liability company is alienated.

The MLI process in short

The process for treaties being amended basically comes down to each individual country selecting what changes they would like to make to their treaties. So each country would state whether they pursue (any combination of) the three

changes mentioned above. Subsequently, the choices of such country are compared to those of other countries and insofar choices “match” changes will be included in the tax treaties following the MLI.

The OECD keeps track of the choices made by each of the countries in a kind of matching database. When looking at the choices of certain Western-European countries there definitely are differences. Certain countries, like France, have real estate company clauses in most existing treaties and wish to extend these with the anti-abuse rules 2 and 3 above. Spain has selected to replace existing clauses with a new clause covering all three items mentioned above. Italy seems to have changed its position from not having real estate company clauses to – similar to Spain – introducing such full scope clause.

Obviously for the market, the question is whether real estate owners should take any action. Now that all countries have made their selections, this would probably be a good time to perform a first analysis. I could be assessed whether the changes to the tax treaty would change prior financial assumptions made at the time of the investment. This could very well be the case with certain countries electing to introduce full scope real estate company clauses in their treaties. It could then also be checked whether financial modelling performed prior to the acquisition anticipated taxation of gains on disposal of shares. If it did the answer to the question whether there is an effective impact could be no. Otherwise, financial projections may have to be updated or it could be considered whether – prior to changes becoming effective – certain changes to an investment structure are required. The choices that have to be made in this respect that could also extend into the wider “responsible tax” discussion and the tax policy of funds and their managers, investors and other stakeholders. ●

Infrastructure in Australia



Damien Frawley

Damien has over 26 years' experience in the financial services sector. He has a strong focus on developing and executing strategy, particularly around growth and sales. Most recently, Damien was the country head of BlackRock Australia, responsible for managing \$45 billion of assets on behalf of clients. Prior to this, Damien was BlackRock's Head of Account Management, overseeing sales, marketing and product efforts across institutional and retail channels. Damien's career has also included roles at Merrill Lynch Investment Management, Barclays Global Investors and Citibank. On a personal note, Damien is a Queenslander and prior to his career in financial services he represented Australia in rugby union.

In the Casey Quirk by Deloitte "Survival of the Fittest" report, it was stated that effective asset managers will have to differentiate investments with a broader array of active capabilities and strong product development processes. With that in mind, Neil Brown, Partner in Assurance & Advisory at Deloitte, has spoken to Damien Frawley from QIC, which is well known for its global diversified alternatives business building on current and future opportunities in infrastructure investing. ➤



Deloitte: What is your view of infrastructure investment in Australia?

Over the past two decades, Australia has become a global leader in infrastructure investment. The strength of the infrastructure class in Australia has been particularly aided by institutional investors' willingness to diversify portfolio exposure away from traditional global equity and debt capital markets. Given that our nation's superannuation system has created a large savings pool, over AU\$2 trillion within the last 25 years, Australia now finds itself in an ideal position to investigate alternative investment solutions.

Through investing in infrastructure, institutional investors have been able to constructively work with all levels of government. This has led to the creation of numerous partnerships which have delivered outcomes that have had positive knock-on effects for various parties including local residents, communities, businesses, and investors.

In February 2017, Infrastructure Australia identified approximately AU\$60 billion in high-priority and priority projects over the next 15 years.

The competition for quality infrastructure assets can be intense, and prices reflect that fact. What qualities do infrastructure assets offer and what is QIC's approach to ensuring it is creating long-term value for investors?

Infrastructure assets have a number of desirable qualities, including a long-term investment horizon, increased cash flow predictability where the asset operates in a monopolistic environment like a seaport or airport, revenues with direct or indirect inflation linkage, relatively transparent legal and regulatory frameworks, and upside potential afforded through increased demand or expansion optionality.

Unlisted infrastructure assets, one of QIC's core focus areas, typically possess additional attractive features. These can include reduced correlation to listed equity markets, which is important for portfolio diversification, and quite often the ability to have direct governance rights at the asset level. This provides an enhanced ability to directly influence the strategy and risk appetite applied to the asset, thus better aligning ourselves with portfolio objectives. While noting that these benefits can come at the expense of reduced liquidity, it is unsurprising that the popularity of unlisted infrastructure as an asset class continues to grow. This seems particularly logical when we consider relative track record. For example, in an Australian context, MSCI data shows that unlisted infrastructure has outperformed equities, bonds, and property in delivering an average return greater than 13 percent per annum over the past 15 years.

Clearly, increased investor appetite brings greater competition in what can be a sparsely populated universe of prospective infrastructure assets. QIC is focused on being highly selective and disciplined in our approach. We prioritize the opportunities where there is enhanced scope for achieving relative value for our clients.

In addition to this, we also seek to prioritize opportunities of a bilateral or less competitive nature to the extent that we pursue investments through a competitive process.



When selecting global markets in which to invest, what key characteristics do you require?

From a geographic perspective, QIC typically focuses on infrastructure investments in OECD countries. This is mainly because of the relatively well-established and transparent legal, regulatory, and economic structures. We strongly believe in the merits of portfolio diversification, so we actively seek out investments across multiple jurisdictions.

More importantly, we also look to unpick the underlying macroeconomic drivers and other asset-specific factors relating to each opportunity from the outset. This process allows us to proactively assess portfolio fit and client suitability through rigorous economic scenario analyses. This includes a correlation analysis with the existing assets of the clients in question.

What qualities make Australia one of the global leaders in infrastructure?

We believe there are abundant factors that contribute to the nation being one of the global leaders in infrastructure. Firstly, Australia was a pioneer of facilitating private investment in public infrastructure. This means that the Australian market is mature and well-accustomed to the sorts of transactions, structures, and models that can be employed. It also allows the market to tailor innovative solutions to specific situations. Secondly, Australia has the same level of legal stability as other OECD countries but boasts relatively favorable demographics and a macroeconomic outlook at the upper end of all OECD member states. This is particularly aided by Australia's advantageous proximity to Asia, given the expected growth potential in this region. Thirdly, Australia is a large country, meaning its infrastructure needs and requirements are extensive. In February 2017, Infrastructure Australia identified approximately AU\$60 billion in high-priority and priority projects over the next 15 years. These projects provide a reasonable pipeline of opportunities for the private sector to become involved either directly or indirectly through schemes like the Federal Government's Asset Recycling Initiative. This initiative encouraged brownfield assets to be sold or leased to generate funds for new infrastructure investment. Further afield, QIC has previously invested in infrastructure assets in emerging markets such as India. We continue to selectively assess opportunities as they arise and to the extent our clients have appetite. Investing in such jurisdictions does not come without challenges. However, as an organization, we recognize and appreciate the long-term opportunities within these markets, further the importance of forging value-adding relationships with local and aligned partners. Making sure these relationships are cemented well ahead of time puts us in prime position for a prosperous and stable future.

Australia has the same level of legal stability as other OECD countries but boasts relatively favorable demographics and a macroeconomic outlook at the upper end of all OECD member states. This is particularly aided by Australia's advantageous proximity to Asia given the expected growth potential in this region.



What opportunities do you believe recent government infrastructure plans, such as those seen in the US, will offer investors?

When designed and implemented effectively, infrastructure can drive economic growth in communities and improve quality of life. Any plans by governments to facilitate new infrastructure or sponsor upgrades of existing assets should be applauded. Given governments' increasing fiscal constraints, it follows that there should be increased scope for parties such as QIC to actively partner with governments to reduce their funding gap. This can be achieved through a private deployment of funds in attractive economic infrastructure opportunities.

With respect to the US, it is clear that there has been an underinvestment of investment in critical infrastructure. With estimates of the funding gap required to bring America's infrastructure to a state of good repair potentially running into the trillions of dollars, it is obvious that private funding will be essential. However, it is important to note that previous attempts to modernize the procurement and funding of infrastructure within the US have been slow and inconsistent, with some high-profile process failures such as Chicago Midway International Airport contributing to investor caution.

While limited details have been provided to date, President Trump's infrastructure plan represents a potential catalyst to revitalize US infrastructure through partnering with the private sector. Recent market commentary suggests as much as US\$200 billion could be sought from the private sector. Should this come to pass, it would represent a significant opportunity for parties such as QIC to invest in critical infrastructure in the world's biggest economy. More importantly, it is pleasing to see growing recognition of the private sector's ability to deliver and manage infrastructure more efficiently through better procurement methods, market discipline, and a long-term focus on optimizing the asset management lifecycle.

From QIC's perspective, we are actively assessing the sectors and regions most likely to benefit from this potential policy shift and increased activity levels. As a long-term infrastructure owner, we will be looking to work with governments at all levels on the best way for the private sector to deliver value for money and bring innovation to P3s (Public Private Partnerships) and asset-recycling programs. In particular, we will be able to offer a wealth of experience drawing on QIC's key involvement in leasing assets from governments and institutions within Australia and abroad, such as the Port of Melbourne, Brisbane Airport, and the parking system at Ohio State University. ●

Any plans by governments to facilitate new infrastructure or sponsor upgrades of existing assets should be applauded.

Recent thought leadership

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



Property Index – Overview of European Residential Markets

Rental market – Is renting a dwelling a profitable investment?
6th edition, July 2017
The sixth edition of the annual Deloitte Property Index compares the residential property markets in Europe. The report analyses the factors that influence the development of residential markets and compares prices in a number of European countries and cities.

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Deloitte Legal Handbook for Real Estate Transactions

The 2nd Edition of Deloitte Legal “Handbook for Real Estate Transactions” gives an overview of the legal framework for real estate transactions related to various asset classes in 24 countries.

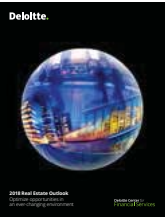
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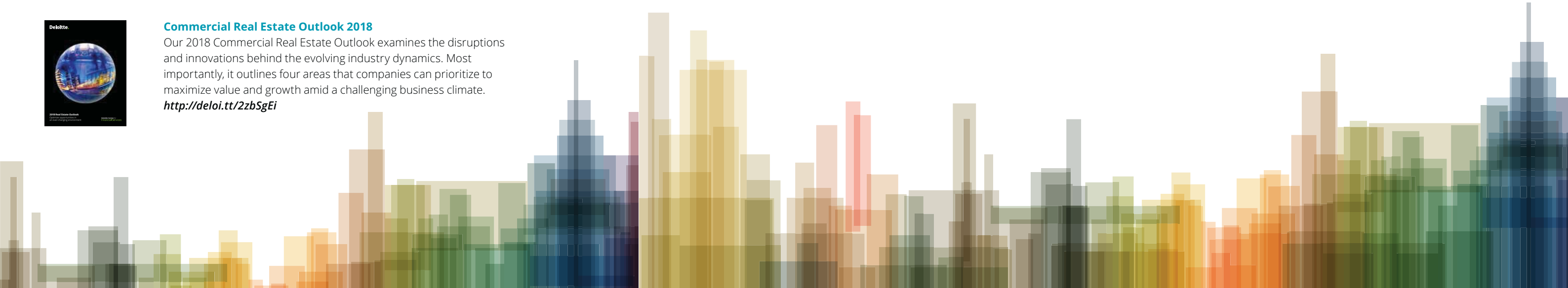
[*http://deloi.tt/2gNh5fQ*](http://deloi.tt/2gNh5fQ)



Commercial Real Estate Outlook 2018

Our 2018 Commercial Real Estate Outlook examines the disruptions and innovations behind the evolving industry dynamics. Most importantly, it outlines four areas that companies can prioritize to maximize value and growth amid a challenging business climate.

[*http://deloi.tt/2zbSgEi*](http://deloi.tt/2zbSgEi)



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