The Real Estate M&A and Private Equity Review

Eighth Edition

Editors

Adam Emmerich and Robin Panovka

The Law Reviews

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THE LAWREVIEWS

Published in the United Kingdom
by Law Business Research Ltd
Holborn Gate, 330 High Holborn, London, WC1V 7QT, UK
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www.thelawreviews.co.uk

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ISBN 978-1-80449-194-2

PREFACE

Real estate investment trusts (REITs) have emerged from covid-19 to face a new reality. Covid's acceleration of a number of key technological trends has changed the way in which we interact with real estate, ushering in an era of increased remote working and online shopping and the adoption of prop-tech into virtually every aspect of real estate. In general, companies with assets that service the digital economy – cell towers, logistics and industrial properties, and data centres – benefited from the pandemic's acceleration of the digital economy, while traditional sectors have had to adapt to the new realities. And the rapid advancement of artificial intelligence promises further change. Additionally, the recent tremors and disruption in the banking industry and the rise in interest rates and inflation, combined with upcoming debt maturities, may portend a volatile period. As always, strategic planning and risk management will be critical to adjust to changing times.

Covid-19 aside, the world is facing a number of macro headwinds that began to rear their heads in 2022, including persistent inflation, a higher interest rate environment, the ongoing war in Ukraine, and considerable turmoil in the banking sector. While there remain opportunities to make strategic acquisitions and investments within real estate, the continued volatility in the near term, and the complex and challenging macroeconomic backdrop will likely continue to have disparate impacts on different subsectors and different geographies within the industry.

Stepping back from recent global events and market dislocations, publicly traded real estate companies and REITs, with help from real estate private equity, have steadily transformed the global real estate markets over the past 25 years. Their principal innovation, and 'secret sauce', has been 'liquid' real estate. Unlike traditional property ownership, equity in publicly traded real estate vehicles is highly liquid, and can be bought and sold in large volumes, literally in minutes, on numerous global exchanges. Indeed, during the pandemic, REITs issued more than US$10 billion in public equity, taking advantage of the massive amounts of liquidity washing over financial markets beginning in the spring of 2020. In 2021, public REITs raised approximately US$27 billion in follow-on equity offerings, declining to approximately US$18 billion during the volatility of 2022.

Publicly traded real estate vehicles now have an aggregate market capitalisation of over US$1.3 trillion globally, including nearly US$1 trillion in the United States and approximately US$130 to US$170 billion in both Europe and Asia. As public REITs and other vehicles have aggregated these properties and grown in scale and sophistication, so too have real estate-focused private equity funds, playing an important role in catalysing hundreds of billions of dollars of REIT and real estate merger and acquisition (M&A) transactions and initial public offerings.

However, despite that massive growth and despite the pandemic, potential growth is far larger both in long-standing REIT markets and in newer REIT jurisdictions, where the trend is more nascent. With increasing development and urbanisation, the world is producing more and more institutional-grade properties, and a growing percentage of this expanding pool – an estimated US$5 trillion and counting – will inevitably seek the advantages of liquidity by migrating to the publicly traded markets. The growth is expected to be both local and cross-border, with nearly 40 countries already boasting REIT regimes. Despite this potential for growth, it remains to be seen whether the ongoing conflict in Ukraine and the associated energy and supply chain disruptions, as well as the rise of populist movements around the globe, will spur a wider backlash against globalisation and cross-border investment.

REITs and other publicly traded vehicles for liquid real estate have grown because they are often a superior vehicle for stabilised assets. Greater liquidity and transparency – and often superior governance – are attractive to investors, resulting in a lower cost of capital and superior access to vast amounts and varieties of capital in the public markets. In addition to cheaper capital, REITs and other public vehicles benefit from efficiencies of scale, sophisticated management and efficient deal structures, to name just a few advantages. With these advantages, the global march of real estate to the public markets seems unstoppable.

This publication is a multinational guide for understanding and navigating the increasingly complex and dynamic world of liquid real estate and the transactions that mostly produce it. The sea change in the markets, sometimes called the REIT revolution, has meant that major real estate transactions have migrated from Main Street to Wall Street. They now often take the form of mergers, acquisitions, takeovers, spin-offs and other corporate transactions conducted in the public markets for both equity and debt. They have grown exponentially in complexity and sophistication, and increasingly represent cross-border multinational transactions fuelled by the now-global real estate capital markets and M&A deal professionals. And they are often intermediated by international investment banks rather than local brokers and financed with unsecured bonds or commercial mortgage-backed securities. In a fair number of cases, they are catalysed by private equity firms or similar actors, sometimes building portfolios to be taken public or sold to public real estate companies, and sometimes through buyouts of public real estate companies for repositioning or sale.

To create this publication, we have invited leading practitioners from around the globe to offer practical insights into what is going on around the conference tables and in the markets in their jurisdiction, with an eye to cross-border trends and transactions. As will quickly become evident, the process of liquefying real estate and transactions involving public real estate companies requires a melding of the legal principles, deal structures, cultures and financial models of traditional real estate, public company M&A and private equity. None of this, of course, happens in a vacuum, and transactions often require expertise in tax, corporate and real estate law, not to mention securities laws and global capital markets. Each of our distinguished authors touches on these disciplines.

We hope this compilation of insight from our remarkable multinational authors produces clarity and transparency in this exciting world of liquid real estate and helps to further fuel the growth of the sector.

Adam Emmerich and Robin Panovka
Wachtell, Lipton, Rosen & Katz
New York
July 2023

Chapter 12

UNITED KINGDOM

Richard Smith, Ed Milliner and Graham Rounce[1]

I OVERVIEW OF THE MARKET

Unfortunately, Russia's invasion of Ukraine continues to dominate the political and economic landscape and, as the war continues into its second year, a peaceful conclusion to the crisis remains a distant hope. Global political risk and a hardening of the macroeconomic environment have overtaken the covid-19 pandemic as the main factors affecting confidence in the real estate M&A and private equity markets. Albeit less significant, the implications of leaving the EU also continue to rumble along in the background. Coming out of lockdown heralded a very welcome resurgence in activity as investors started to embrace a return to pre-pandemic conditions and take advantage of investment opportunities. Difficult times call for strong and stable government. Unfortunately, the UK has had anything but, as Boris Johnson was replaced as Prime Minister by Liz Truss, whose economic policies saw her replaced after a mere seven weeks by Rishi Sunak. It is hoped that Sunak and his Chief Finance Minister, Jeremy Hunt, can do enough to steer the UK through choppy waters ahead of a general election likely to take place in 2024.

In addition to the humanitarian crisis, Vladimir Putin's invasion of Ukraine has, of course, had a significant effect on the European economy. Real estate investment confidence has been knocked and real estate M&A and private equity activity has dwindled. In short, political and economic uncertainty has destroyed the optimism and confidence present at the start of last year. In addition to any direct exposure to Russian real estate, there is also the more complicated issue of extricating deal structures from Russian-backed ownership and financing. The war means that cross-border deals have become more complicated and more challenging. It has also led to a number of sanctions and other measures aimed at Russia, as well as economic crime more generally. The Economic Crime (Transparency and Enforcement) Act 2022 provides for a new beneficial ownership register for overseas entities holding UK real estate, the strengthening of unexplained wealth orders and the more effective enforcement of sanctions. Although the introduction of the new legislation was accelerated by the war in Ukraine, much of it had been planned for some time. All overseas companies owning UK property must register details of their beneficial ownership. However, this is not expected to create an onerous burden for legitimate overseas investors seeking to acquire UK property and is unlikely, of itself, to deter investment. The UK's real estate markets have traditionally proved to be remarkably resilient in difficult times, offering a safe haven to

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investors in times of political and economic instability. In particular, non-listed real estate companies tend to weather geopolitical uncertainty relatively well and real estate is often considered to be a good hedge against inflation.

Real estate had already been hit extremely hard by covid-19 with a sharp decline in values across most sectors. Retail and leisure were already in serious decline and have suffered the most, as the cost-of-living crisis almost seamlessly replaced lockdown as the dominant headwind. Hopes of a swift bounce back have been thwarted as the UK economy continues to flirt with recession, and a combination of inflation, rising interest rates and widespread industrial action have crushed consumer confidence and stifled business optimism. Surging prices and limited growth have raised fears of a return to the stagflation of the 1970s. The government's covid-19 tenant protection measures have come to an end and landlords are now, at least in theory, free to take enforcement action. However, the message that the situation is not the fault of any particular party holds true and landlords, tenants and their respective funders are continuing to work together to find a sustainable solution as difficult times look set to continue for some time to come. Little or no economic growth and the fear of an economic recession following hot on the heels of lockdown is proving a challenge for a cash-strapped government to deal with.

Following on from COP26 in Glasgow, the great and the good descended on Sharm El Sheikh in Egypt for COP27. Again, certain key world leaders were conspicuous by their absence and the UK's new Prime Minister decided to attend only at the last minute. Much of the focus this year was on reaching a deal to provide funding for the climate change costs suffered by the world's poorer nations with agreement reached on a new Loss and Damage Fund. Increasing global temperatures continue to raise concerns and, as is often the case, it is the developing world that is often the hardest hit. In addition to being an obvious casualty of climate change, the built environment is also a major contributor to the problem. Buildings account for at least 25 per cent of the UK's greenhouse gas emissions and yet there remains a sense that property continues to be underrepresented. Nonetheless, there is now a sense that the prioritising of environmental, social and governance (ESG) issues has gained traction and is finally receiving the industry's full attention. Although there is still plenty of work to do, investors, landlords, tenants and their respective lenders are starting to pull together in the same direction. Collaboration and, in particular, the sharing of data is essential. It is important to remember that much remains to be done and short-term economic and political upheaval should not mean the abandonment of long-term thinking on sustainability. A more fundamental concern revolves around the UK's large stock of older, lower value and underperforming buildings where radical energy efficiency improvement works are unlikely to be economically viable without government funding. One issue for real estate is the continued lack of a global baseline; the plethora of standards, while well-intentioned, can be confusing, particularly to overseas investors.

The office sector is still in the process of a major reset. Covid-19 lockdowns and the move to working from home had a profound effect on the market as occupiers across the spectrum were forced to re-evaluate their UK and global office requirements. Unsurprisingly, the perfect storm of covid-19 followed by the inevitable economic stagnation means that the office letting market has been, in general, subdued and volumes remain down. Despite this, larger corporates and professional firms have continued to see the need for a landmark headquarters building to identify with their brand. International law firms have been particularly active and Slaughter and May is pleased to have helped Clifford Chance, Linklaters, Allen & Overy, Baker McKenzie, McDermott Will & Emery, Kirkland & Ellis,

Skadden, Arps, Slate, Meagher & Flom, Reed Smith, Travers Smith and others on their new London headquarters moves. Although there has been some rightsizing, the feared large-scale downsizing by corporate occupiers has failed to materialise and there is less vacant space than previously envisaged. The focus has been on using existing space differently. It is increasingly the view that the office must provide a positive experience with attractive amenities and facilities to offset the appeal of working from home and the drudgery of the commute. The London office market offers flexibility to occupiers adjusting to new ways of working. In addition to landmark headquarters buildings, flexible short-term serviced office space continues to prove attractive as businesses settle on their preferred working model. Unsurprisingly, real estate investment volumes have also been adversely affected and the post-pandemic surge in activity has slowed in the face of persistent economic and political uncertainty. Despite the slowdown, continued interest from overseas investors suggests that London and the wider UK remain high on the shopping lists of global investors looking for value and security. Indeed, the weakness of the pound has created buying opportunities for those investors transacting in US dollarpegged currencies. Those fortunate to be sitting on stockpiles of cash will also be able to move swiftly as rival bidders are tested by challenging debt financing conditions.

Although the construction pipeline is reasonably strong, much of the new office space has been pre-let, helping to maintain healthy competition for available space. Outside of London, the regions will continue to benefit from the government's levelling-up objectives, including confirmation of the Northern Powerhouse and HS2 rail projects, albeit that the likely scaling-back of the latter is disappointing. Continued decentralisation will benefit cities such as Manchester, Leeds, Edinburgh and Birmingham. The latter, together with the wider Midlands area, is enjoying a boost from last year's Commonwealth Games and the legacy opportunities that follow the staging of a major international event. Those regional cities offering a strong talent pool combined with up-to-date amenities have proved particularly attractive for occupiers and investors. Appetite for UK property is no longer totally focused on London and knowledgeable overseas investors have continued to look further afield for opportunities. Although London will undoubtedly retain its attraction as a key global city in which to live, work and do business, rapidly evolving technology and flexible working practices mean that not everyone needs to be in the head office all of the time. While major domestic and international businesses are still likely to look for a flagship Central London headquarters building, that building may well be smaller than before and repurposed away from simply providing as much desk space as possible.

Sustainability is becoming increasingly important as landlords, tenants and funders come under pressure to achieve ESG targets. As ESG strategies develop, occupiers have become more willing to contribute to the associated costs in order to protect brand reputation and attract and retain the best talent in a competitive labour market. This will focus demand on new developments allowing an occupier to impose its green credentials as part of its corporate identity. For example, the lease of Jones Lang LaSalle's new Docklands offices contains the first legally binding green lease provisions on the Canary Wharf Estate. The majority of new take up is for smart buildings with high sustainability credentials and a BREEAM (Building Research Establishment Environmental Assessment Method) rating of 'very good' or higher. Proptech has become a key part of the race to net zero, helping to make buildings smarter and better connected, as well as improving environmental efficiency. For instance, digital twin technology will help predict the use, performance and energy requirements of buildings, new developments and, ultimately, towns and cities. This increased use of data and

technology in turn emphasises the importance of cybersecurity and the sector's vulnerability to hacking, cybercrime and cyber warfare or terrorism. The proliferation of proptech startups means there will be plenty of investment and M&A opportunities for investors looking for the next unicorn or dragon in the sector. In addition to consolidation, established property companies will look to enhance their offering by tapping into the sophisticated new skill sets, which extend well beyond traditional operation and maintenance. The British Property Federation's proposed merger with the UK PropTech Association underlines the significance of innovation for an industry facing rising costs, a myriad of new regulations and the challenge of climate change.

Rental values in the co-working sector have improved, initially in the wider market and ultimately in core office locations following the start of the back to the office migration. The demand for flexible space will remain and serviced offices have become an essential requirement for fledging businesses as well as a key part of the occupation strategy of larger occupiers needing flexibility and the ability to move staff quickly. In uncertain times, businesses are happy to trade higher rents for limited or no capital costs. The co-working sector has become an established part of the market, including the development of sub-markets as operators have sought to establish niche appeal. The sector will continue to be driven by demand for good quality office space, available on flexible terms and in well-located, safe and sustainable office buildings with top facilities and state-of-the-art connectivity.

Other than work-life balance, affordability is affecting the residential market with rising interest rates and a widening gap between wages and soaring inflation. Other factors include concerns about cladding and the safety of taller blocks of flats, and a shortage of new homes coming to market. The country's housing crisis continues as successive governments have failed to meet newbuild targets. Each year, the government sets a target of 300,000 new homes that it routinely fails to meet. The UK's rising population will ensure that residential property will continue to provide opportunities for investors. Unfortunately, a shortage of labour and global inflation has led to increased building costs and slow construction progress, with delays in the supply of building materials and difficulties in ensuring the availability of a skilled workforce. A combination of rising costs, a fall in sales and pressure on pricing suggests that housebuilders may pause projects and sit on their development land banks until conditions start to look more promising. In particular, the viability of the affordable element of new developments has been undermined by tighter margins. Global economic headwinds have been offset by rising rents as the number of properties for rent falls short of demand and employment statistics, despite some high-profile losses in the technology sector, remain strong. More affordable homes are urgently required and there needs to be greater focus on social and economic factors in deciding where these should be built. Affordable housing and build to rent will make up a larger share of new developments and institutional investors are now alive to the opportunities. The residential market will become tougher in 2023 as economic pressures, higher finance costs and less favourable tax and legislative regimes for buy-to-let landlords, including the proposed abolition of 'no fault' evictions under the Renters (Reform) Bill, start to have a cumulative effect. Overseas investors in residential property are now also subject to a 2 per cent stamp duty land tax surcharge that comes on top of the existing 3 per cent surcharge for additional properties and the 15 per cent rate for those buyers using corporate vehicles.

With the exception of the major supermarkets and established online retailers, it has continued to be a particularly difficult time for the UK's retail sector. A succession of household names have continued to join the seemingly endless list of casualties in a sector

struggling even before the pandemic. Yawning gaps on the high street, a proliferation of American candy stores and empty shopping centres stand as testament to a sector that has changed beyond all recognition. Traditional retailers have been forced to adapt to the changing habits of their customers, while online retailers and delivery companies have benefited from a significant change in customer habits. Investors will continue to rethink how they see retail assets and there will be a renewed focus on repurposing available space for residential, logistics, leisure and other more innovative uses. In addition, more experiential retail with the use of immersive technology may blur the distinction with leisure and recreation. A number of major high street retailers have confirmed plans to diversify and to repurpose the upper floors of flagship stores as offices or residential spaces. Despite high vacancy rates, there is some cause for optimism as a number of value operators have confirmed plans to expand and smaller independent operators have the opportunity to take prime space vacated by larger chains on flexible and affordable terms. Oxford Street has received a welcome boost with confirmation that HMV is returning to its original home, replacing one of the ubiquitous American candy stores. Pop-up retail and food outlets that can adapt quickly to events and demand have become an established part of the market. While London's West End has benefited from a gradual uptick in international and domestic visitors, the City remains much quieter as workers continue to stay at home. Those workers returning are at their highest concentration in the middle of the week, and the City is noticeably quieter on Mondays and Fridays. This has made it difficult for the coffee shops and other businesses dependent on a consistent flow of customers to build up a proper head of steam. Restaurants and bars emerging from lockdown have struggled to find staff in a tight labour market and the cost of living crisis means the pressure is back on as discretionary consumer spending falls back.

The industrial sector continues to attract investment and well located, high-specification distribution centres in the right locations remain in demand. Logistics has been a rare success story with online retailers looking to expand and refine their distribution networks as the pandemic accelerated the demise of traditional retail. Despite indications that hard-pressed consumers have reined in their online spending, the sector has proved to be an attractive target for investment capital with logistics assets high up on the wishlists of a range of overseas and domestic investors. In addition to good road and rail connections, an acute labour shortage means that the availability of a pool of skilled and unskilled workers has become an important factor in choosing viable locations. The process of onshoring production capability and shortening supply chains should also enhance the UK industrial market and boost local economies. The UK offers plenty of opportunities for specialist manufacturing businesses seeking to take advantage of rising costs associated with existing supply chains, as well as helping customers to reduce their carbon footprint. The challenges lie with the existing development pipeline and the lack of available new stock. The UK has enjoyed a boom time for a TV and film industry looking to catch up on a backlog of content. Out of adversity comes opportunity, with large vacant retail units offering opportunities for repurposing as studio space. Generous tax breaks combined with production facilities and a pool of trained crew continue to make the UK an attractive filming location. Although pressures on disposable income mean that take-up for streaming services has fallen from its lockdown peak, a huge amount of new material is still required just to keep pace with existing schedules. There has also been an increase in hyperscale data centres, although the UK and Europe remain significantly behind the US and China in this sector.

Alternative assets have become an established part of the investment market, alongside the traditional office, retail and industrial sectors. The build-to-rent boom continues as institutional investors look to increase their market share and there has been an increase in the number of new projects in the construction pipeline, both in London and the regions. This investment is timely as squeezed buy to let landlords continue to exit a sector traditionally dominated by a larger number of smaller private investors. Institutional investors are likely to be more conscious of the ESG agenda as well as the need to provide uniformly high standards of accommodation. A number of high-profile private equity backed investment vehicles have signalled an intention to develop and operate new tech-enabled build to rent neighbourhoods, underlying the growing significance of technology-led platforms in the sector. Despite operational difficulties, confidence remains high for operators in the specialist retirement living and student housing sectors, where major institutional investors are looking to increase their portfolios. Purpose-built student accommodation has largely weathered the storm now students have returned to campus. Although demand from private equity and institutional investors remains high for quality stock in strong regional cities, compressed yields are leading to more speculative development funding as investors look for value in the wider student accommodation market. The retirement living sector has much further to go if it is to emulate the North American, Australian and New Zealand models and meet the needs of an ageing population. Later living developments must provide an attractive community in which to live that adapts to provide care as the need arises. The focus to date has been on high-end luxury later living schemes in expensive locations, but demographics confirm that more affordable options offer scalable opportunities for growth. Perhaps not surprisingly, there has been a surge of interest in the life sciences sector, with the London-Oxford-Cambridge golden triangle attracting the most attention. Innovation hubs thrive on shared technology and a dynamic talent pool and must compete on a global platform. Once established, they in turn boost investment in housing, ancillary offices, infrastructure and leisure facilities. Next-generation science, innovation and technology will become a key part of the real estate market as well as the wider economy. The hotel and leisure sector has benefited from a return to healthy occupancy rates as confidence returned in the travel industry. In addition to trophy London hotels, investors have looked for opportunities in the expanding budget hotel sector.

Despite caution in the banking sector, the real estate finance market has been supported by borrowers rushing to refinance and it is hoped that an already diverse lending market will help maintain liquidity as alternative credit providers look to deploy their capital by exploring flexible and creative solutions. A significant development has been the emergence of green financing to support developments and activities with a green or broader social purpose. Sustainable finance has become an established component of lender and corporate business strategies. Inevitably, a protracted period of economic stress will prove to be too much for some borrowers and there will be an increase in transactions involving distressed assets and mortgage debt. Cash buyers are likely to be at the top of the pecking order as opportunities come to market. Despite the recent collapse of Silicon Valley Bank, First Republic Bank and Signature Bank of New York, fears of a new financial crisis have been downplayed and UK banks remain well capitalised and in good shape to cope with financial stress.

II RECENT MARKET ACTIVITY

a City Developments acquired a portfolio of student housing buildings from Colliers International for £185 million.

b Civitas Investment Management acquired a portfolio of specialist-care properties from CareTech Holdings for £200 million.

c ProLogis acquired a portfolio of 128 logistics facilities and six developments across Europe from Crossbay for €1.585 billion.

d Sainsbury's Reversion Portfolio has acquired a 51 per cent stake in Property Portfolio from Supermarket Income Reit for £430.9 million.

e Brookfield Asset Management and Copley Point Capital have acquired a £125 million logistics portfolio from Tritax Big Box REIT.

f Convene Technology acquired ETC. Venues from Gencom Group, Benchmark Hospitality and DigitalBridge Group.

g Chinachem Group acquired One New Street Square from Land Securities for £349.5 million.

h British Airways Pension Investment Management has acquired a 25.5 per cent stake in Sainsbury's Reversion Portfolio for £196 million.

i Ontario Teachers' Pension Plan, Cadillac Fairview Corporation and Boreal IM acquired three logistic warehouses from Abrdn for £145 million.

j Xior Student Housing is to acquire Basecamp Group for £939 million.

k The Ontario Teachers' Pension Plan, Cadillac Fairview Corporation and Boreal IM has acquired two industrial parks in London and Rotterdam for £250 million.

l GIC has acquired 75 per cent of Paddington Central Assets from British Land for £694 million.

m John Menzies has been acquired by Agility.

n Workspace Group acquired McKay Securities for £422.379 million.

o Central Group and SIGNA Holding acquired Selfridges & Co. for £4 billion.

p City Developments acquired St. Katharine Docks from Blackstone for £395 million.

q Columbia Management Investment Advisers and Delancey Real Estate Asset Management acquired a 50 per cent stake in Castlepoint.

r Lembaga Tabung Haji acquired the Great Minster portfolio from Sinarmas Land for £247.5 million.

s Brookfield Asset Management sold 2 London Wall Place to Kingboard Holdings for £293.6 million.

t Capital & Counties Properties acquired the remaining 74.76 per cent stake in Shaftesbury.

u Leftfield Capital has been acquired by Kennedy-Wilson Holdings for US$287 million involving 20 UK logistics assets.

v Qatar Investment Authority has acquired a 20 per cent stake in DREAM INTERNATIONAL from Dogus Holding.

w Brookfield Asset Management has sold Student Roost to Greystar Real Estate Partners and GIC Real Estate for £3.3 billion.

x Greenpoint Partners, GCM Grosvenor, Ivanhoe Cambridge and Greater Manchester Pension Fund have acquired National Car Parks for £305 million.

y Blackstone has sold Butlin's to the Harris Family Trusts for £300 million.

z M7 Real Estate has sold a European portfolio of logistics assets to Blackstone for €125million.

aa LXi REIT has acquired secure income REIT for £1.36 billion.

ab The Office Group acquired Fora Space from Brockton Capital.

ac Blackstone has confirmed a £511 million take-private for Industrials REIT.

ad PGIM Real Estate has acquired a residential portfolio form Goldman Sachs for £204.4 million.
ae Morrisons entered into a £220 million sale and leaseback deal with ICG.
af Goldman Sachs and Greycoat acquired 10-15 Newgate Street for £370 million.
ag Landsec sold 21 Moorfields to a vehicle managed by Lendlease for £809 million.
ah Shimao sold the Sancroft building at St Pauls to Greycoat and Mitsui Fudosan for £315 million.
ai Crimson Hotels acquired Trafalgar St James Hotel from L+R Hotels for £130 million.
aj Whitbread acquired 5 Strand from ABIL Group for a new £200 million Premier Inn hotel.
ak Prologis acquired two prime urban logistics estates from Schroders for £200 million.
al Nuveen has sold a 33.3 per cent stake in the Bullring Shopping Centre in Birmingham to Canada Pension Fund Investment Board.
am Alberta Investment Management and Ridgeback Group have bought a £283 million build-to-rent portfolio from Angelo Gordon.
an Straits Real Estate acquired Gloucester Business Park from Advanced Research Clusters for £130 million.
ao Longfellow Real Estate Partners and Canada's Public Sector Pension Investment Board acquired Capital Park for £170 million from Oval Real Estate.

III REAL ESTATE COMPANIES AND FIRMS

i REITs

The UK real estate investment trust (REIT) regime came into force in January 2007. It exempts from corporation tax the income and capital gains of a UK REIT's property rental business. The income and capital gains of any other business, including from acquiring or developing property for sale, is taxed at the main corporation tax rate (currently 25 per cent). The *quid pro quo* is that distributions from UK REITs are generally subject to withholding tax and treated as property rental income in the hands of investors. While not all property companies are REITs by any means, the largest corporate real estate groups are structured as REITs to benefit from these tax advantages. As a result, M&A involving UK REITs will have specific considerations that will need to be taken into account.

Main conditions

A UK REIT can consist of either a single company or a group of companies. The basic conditions that must be met by the company or parent company of a group are:

a it must be resident only in the United Kingdom for tax purposes;
b it can have only one class of ordinary shares, which (generally speaking) must be admitted to trading on a recognised stock exchange, and either listed or actually traded on such an exchange;
c it must not be a close company (a company that is controlled by five or fewer shareholders), although close companies that are controlled by certain institutional investors, such as pension funds, charities, certain collective investment schemes and other REITs, are allowed; and
d the property rental business must constitute at least 75 per cent of the total profits and assets of the company or the group.

There are also diversification rules requiring a business to hold at least three properties, each representing no more than 40 per cent of the total value of its portfolio.

To ensure that the property income generated by a property rental business is ultimately taxed, at least 90 per cent of the income profits of the business must be distributed annually by way of dividends. A UK REIT is subject to a tax charge to the extent that it falls short of this.

A leverage requirement is also imposed such that the gross income of a UK property rental business must cover the external financing costs of the entire property rental business by a ratio of at least 1.25:1. Again, a tax charge is imposed on UK REITs to the extent of any excess financing cost.

Takeover of a UK REIT

If a UK REIT, whether a single company or a group, becomes part of another REIT, it will remain within the UK REIT regime as long as the conditions continue to be met. A takeover may well cause the company (or parent company of a group REIT) to become a close company unless the terms of an acquisition are such that at least 35 per cent of the ordinary shares remain in public hands. UK and equivalent foreign REITs are now recognised as institutional investors, which should deal with that point in most cases – however, it will not always be the case that a foreign entity labelled as a REIT will be equivalent to a UK REIT, so a degree of circumspection is required. In a cross-border context, the impact of the leverage requirement – in that it looks at gross income of the UK property rental business only but takes into account the external financing costs of the worldwide property rental business – will need to be considered.

ii Recent developments

The introduction of UK REITs in 2007 coincided with the beginning of a major downturn in the commercial real estate market. UK REITs were conceived during a UK property boom and consequently faced challenges during the financial crisis.

However, as property prices recovered, there emerged a renewed interest in UK REITs as a tax-efficient investment structure, especially following the abolition of a 2 per cent entry charge on seeding assets in 2012. The introduction of the UK REIT regime was a significant improvement to the tax environment for UK real estate companies and has since developed in a broadly investor-friendly way, leading to a positive impact on the UK-listed real estate sector. That said, the introduction of the indirect chargeable gains charge in 2019 (discussed in more detail below) has possibly soured things a little by making disposals by non-residents of holdings in UK REITs subject, in principle, to UK tax. The UK REIT sector now includes some of the United Kingdom's largest real estate companies, such as Land Securities, Derwent London, British Land, SEGRO, Great Portland Estates, Hammerson and Canary Wharf Group. The number of UK REITs has grown significantly in recent years (including externally managed UK REITs) to more than 100.

iii Real estate private equity firms

Structure

In the United Kingdom, real estate private equity firms can be structured in a number of ways. As a result of regulatory and tax issues, which affect the operation of a fund and its investors, the most common structure in the United Kingdom is an English (or Scottish)

limited partnership. Generally speaking, these vehicles have no legal status in their own right (although Scottish limited partnerships do have separate legal personality); in essence, they exist only to allow the partners to act collectively. Each partnership:

a has a finite life (usually 10 years with a possible two-year extension, although some have investors with rolling annual commitments);
b has one general partner with unlimited liability for the liabilities of the partnership;
c has a number of limited partners (LPs) whose liability is limited to the amount of their equity investment in the partnership; and
d is managed by an investment manager on behalf of all the partners.

The investment manager is a separate entity (owned collectively by the private equity fund managers). It is structured as a partnership (then an offshore limited partnership). The manager receives a fee from each fund it manages.

The general partner is a company owned by the investment manager and, in compliance with the Limited Partnerships Act 1907, must have unlimited liability for the liabilities of the private equity fund. However, the individual partners cap their liability by investing through a limited company. Individual partners of the private equity fund manager are required to invest their own money directly in the fund (usually between 1 and 5 per cent of the fund).

External investors are LPs. Their total liability is limited to the amount of capital they have invested. LPs themselves may be structured as corporations, funds or partnerships.

Footprint

Private equity firms have been major investors in UK real estate in recent years. Investment has been made across a wide range of sectors including hotels, residential schemes, housebuilding, healthcare, student housing, restaurants, serviced offices, logistics and retail.

Private equity firms have continued to raise large amounts of capital for investment in UK and European real estate, and investment activity has been buoyed by the relatively low risk opportunities afforded by real estate in terms of a reliable income stream and capital growth.

IV TRANSACTIONS

i Legal frameworks and deal structures

Legal frameworks

When investors acquire or dispose of real estate in the United Kingdom, the majority of deals do not involve a transfer of title to the relevant property from the seller to the buyer. While smaller deals may involve the direct transfer of real estate assets, for a number of reasons (the main driver is often tax, as outlined below) the acquisition or disposal of real estate assets is made through share purchases of corporate vehicles that own the property in question. It is unusual for there to be a direct transfer of real estate.

Various structures are used to acquire and hold real estate. The optimum structure will depend on, in each case, a number of factors and considerations (including funding, tax and exit routes (for private equity funds)). Typical structures include:

a companies limited by shares: body corporates with a legal personality distinct from those of their shareholders and directors: these companies are governed by the Companies Act 2006;
b limited partnerships: discussed above in relation to private equity firms;

c limited liability partnerships (LLPs): bodies corporate with a legal personality distinct from those of their members. Members have limited liability in that they do not need to meet the LLP's liabilities. They are governed by the Limited Liability Partnerships Act 2000 and the Companies Act 2006;

d joint ventures: there are no laws relating specifically to joint ventures under English law; their structure will be determined by the nature and size of the enterprise, the identity and location of the parties and their commercial and financial objectives. The relationship between the parties will be subject to, depending on the structure, general common law rules, the legislative provisions of company and partnership law and the provisions of the joint venture agreement;

e trusts of land: any trust that includes land as part of a trust property will be a trust of land. Trustees have the power to sell the property, but no obligation to do so, unless this is expressly provided for. They are governed by the Trusts of Land and Appointment of Trustees Act 1996; and

f REITs.

Deal structures

Share acquisitions with cash consideration remain the predominant form of real estate transaction structure. This is likely attributable to the relative simplicity of completing a transaction structured as a share acquisition and, from a valuation perspective, the certainty of receiving cash consideration.

Fixed-price transactions (often in the form of locked boxes) are the structure of choice for private equity sellers, although they are increasingly used by trade sellers conducting auctions. Earn-outs and deferred consideration are not common features of the UK real estate M&A market.

Post-completion adjustments to the purchase price are also a common feature, particularly where there is a delay between signing and completion (see below). Adjustments are most commonly made to account for variations in working capital and net debt.

The use of escrow structures has also increased in the real estate private equity M&A market as a way to make contractual claims in respect of warranties and post-completion purchase price adjustments.

Acquisition agreement terms

As previously noted, typically real estate assets will change hands through a sale of the shares in a corporate vehicle that owns those assets. As with any share deal, the buyer will take on the target's existing liabilities and commitments and the seller will provide warranties and certain indemnities. The title to the real estate assets will usually be certified by the seller's counsel. The extent of the sale and purchase agreement (SPA) provisions will vary depending on the nature of the transaction, the real estate assets in question and the due diligence undertaken. However, there are a number of aspects to consider.

Conditionality

A number of conditions may need to be satisfied before a real estate transaction can complete (such as obtaining planning permission, third-party consents or even practical completion of a property development). Any such conditions must be satisfied or waived before the real estate transaction can complete.

Splits between signing and completion

For any split between signing and completion, several practical matters should be considered, including whether:

a shareholder (or equivalent) approval is required by either party;

b EU merger clearance is required;

c any warranties given at signing need to be repeated at completion;

d rescission is possible between signing and completion;

e any deposit paid at signing should be returned to, or forfeited by, the buyer if the transaction does not complete; and

f management of the underlying properties is required and, if so, whether the buyer will exercise control.

Rescission

Where there is a split between signing and completion, this may affect whether a buyer is able to negotiate a rescission right, as mentioned above, during that time.

Where sellers are required to obtain shareholder approval for a real estate transaction after signing but before completion, it will be difficult for them to argue that during this period the buyer should face the potential risks and be unable to rescind.

In contrast, where the reason for a split is as a result of the time required by the buyer (e.g., to procure debt finance), it is less likely the buyer will be able to negotiate a rescission right for anything other than material breach of any restrictive conduct provisions.

Buyer protections

In UK real estate acquisitions, buyer protections are particularly important as the buyer is not afforded any statutory or common law protection on acquisition; *caveat emptor* (buyer beware) applies. Where a buyer purchases a target group and is to inherit all related obligations, liabilities and commitments, a robust package of warranties and appropriate indemnities will be required from the seller. These will normally be limited to the corporate vehicle and taxation matters; the buyer will usually be expected to satisfy itself on title to the real estate assets through a normal due diligence exercise or reliance on certificates of title issued by the seller's lawyers. Recently we have seen a move towards title insurance as a way for buyers to deal with title due diligence, sometimes in combination with purchaser due diligence or certificates of title, or both of these. A combination of approaches is not uncommon on portfolio deals with properties of various values or significance.

Warranties

Although sellers (particularly private equity sellers) will not want to provide a large number of warranties on the sale of real estate assets, they are important to provide buyers with some contractual protection. An SPA will not generally include long-form property warranties; the buyer's property enquiries will be answered by the seller in the form of representations.

Buyers are increasingly succeeding in extending the scope of warranty coverage, although sellers often succeed in disclosing all due diligence information against such warranties. Private equity sellers have also conceded business warranties on occasion (however, these tend to be in respect of identified issues that cannot be addressed through further diligence or otherwise reflected in the price).

The repetition of warranties at completion is usually limited to core warranties regarding title to shares or real estate assets and the capacity and authority of the seller to enter into a transaction.

Indemnities

Where a buyer identifies (through due diligence) a particular risk or liability that it is unwilling to assume (e.g., environmental risks or planning liabilities) and that risk is not easily quantifiable, specific indemnities will be sought, shifting the exposure to the seller. Warranty claims are difficult to make in practice, so indemnities are preferable from the buyer's perspective. Sometimes title insurance to protect against a specific title defect can be obtained.

Seller protections

The limitations on a seller's liability under an SPA will be dependent on the particulars of each transaction. In practice, however, the parties will agree that certain warranties (i.e., core warranties) will be capped at the overall consideration for the deal. Depending on commercial and competitive pressures, there may be a different cap on liability for other warranty breaches (e.g., 15 to 20 per cent of the overall consideration).

General warranties are likely to have a duration of 18 months to two years, while tax warranties are more likely to have a duration of four to six years. There is also likely to be a *de minimis* threshold that must be reached before a claim is brought.

As previously noted, the seller's exposure under the warranties will be limited by the disclosures made in the disclosure letter (which the buyer will ensure are sufficiently detailed so that a view can be taken on its liabilities).

There is a growing tendency for both sellers and buyers to obtain warranty and indemnity insurance in the UK M&A market. Insurers are increasingly marketing their willingness to offer warranty insurance, although they expect that careful due diligence will be carried out in the normal way by the buyer. This trend has been driven by sellers seeking a clean exit – a broader set of warranties can be presented with limited post-completion financial exposure. Similarly, buyers are arranging insurance to supplement or cover gaps in the protection provided by sellers – securing sufficient protection can allow buyers to proceed with a transaction without raising a seller's exposure and potentially prejudicing the competitiveness of any offer.

ii Financing considerations

Real estate investors are usually backed by a mixture of debt and equity. Lenders will require typical security packages in relation to real estate lending, which will consist of:

- *a* charges by way of legal mortgages over real estate assets;
- *b* charges over rents receivable;
- *c* potential charges over bank accounts into which rents are paid; and
- *d* additional charges over certain contracts (such as leases, insurance policies and development and construction contracts).

Depending on the circumstances, lenders may also seek protection against borrower default through conditions precedent and direct covenants in the facility agreement, property valuations, parent company guarantees and bonds, and cash collateral, and by obtaining floating charges from the parent company.

Where development and construction are anticipated, lenders may also require approval of material development documentation as a condition precedent to drawdown and may expect to receive collateral warranties or third-party rights from contractors, designers and key sub-contractors. Step-in rights may also be sought to take over a contract in the event of default.

iii Tax considerations

Stamp duty land tax (SDLT) is payable by the buyer of commercial real estate in England or Northern Ireland and is a percentage of the purchase price, varying depending on the consideration paid for the property. SDLT is currently payable at 2 per cent on the portion of consideration between £150,001 and £250,000, and 5 per cent on the portion of consideration above £250,000. Similar taxes apply in Scotland and Wales. For investors to avoid paying high tax rates for individual real estate assets, it is generally better for the shares in the vehicles themselves to change hands. SDLT does not apply to the purchase of shares in companies holding real estate assets (at least, not yet – see below). The rate of stamp duty on the transfer of shares in a UK-incorporated company is 0.5 per cent.

If real estate assets are sold and purchased directly, the default position is that the sale or purchase in the United Kingdom is not subject to VAT, although owners can 'opt to tax' a property so that any sale (or letting) becomes taxable at the standard rate of 20 per cent. Generally, most owners opt to tax – the exceptional cases tending to be where the occupational tenant is one with restricted VAT recovery, such as a bank or insurer. Where a property is currently let or a letting has been agreed, VAT can be mitigated by ensuring the sale is treated as outside the scope of VAT as a transfer of a business as a going concern (TOGC), provided the buyer continues to carry on a letting business at the property and itself opts to tax (and so notifies HMRC). Otherwise, even if the buyer can recover all of the VAT charged on the sale, the VAT amount will count as part of the consideration on which the SDLT charge is calculated and thus create an absolute cost in all cases.

Interest charges on borrowings by corporates are, generally speaking, deductible expenses for tax purposes, so gearing will generally result in tax efficiency. Many real estate investors introduce borrowing to achieve this result. In such circumstances, it is important that any shareholder loan arrangement is at arm's length. To the extent that loans do not meet that commercial threshold, interest on them will not qualify as being deductible.

With effect from April 2017, the UK introduced a new restriction on the deductibility of debt finance for corporation tax purposes, similar to those that have existed for some time in other jurisdictions. The UK regime limits interest deductions to 30 per cent of a group's taxable earnings before interest, taxes, depreciation and amortisation (EBITDA). The intention is more to discourage groups shifting a disproportionate amount of debt into the UK than to attack debt finance as such. Accordingly, groups that are highly geared on a worldwide basis may benefit from making an election that permits the use of a percentage based on the ratio of the group's net interest expense to its global accounting EBITDA. There is also an exemption for third-party debt incurred by infrastructure companies that, somewhat generously, extends to companies carrying on a UK property letting business (provided the leases in question are to third parties and do not exceed a duration of 50 years).

With effect from April 2019, non-resident companies became subject to tax on profits and gains arising from holding or disposing of UK real estate in the same way as UK-resident companies. Previously, non-resident investors paid only income tax on rents, and, although disposals of residential property by non-residents have been subject to capital

gains tax since 2015, the new tax charge covers all forms of UK property. A more surprising part of this package was that non-residents that dispose of indirect interests in UK property (essentially, shareholdings in UK property-rich companies or collective investment schemes) became in principle liable to UK tax on any gain, subject to any exemption and the terms of any applicable double taxation treaty. A company will be UK property-rich if more than 75 per cent of its gross asset value is attributable to UK real estate (whether held directly or via subsidiaries). A non-resident will be subject to tax on any gain if it holds a 25 per cent or greater interest in the company, or has done so within the preceding two years and with interests held by connected parties being aggregated. However, investors in collective investment schemes (including UK REITs) do not benefit from this 25 per cent threshold unless the vehicle they invest in is widely held and is marketed as being invested as to no more than 40 per cent (by market value) in UK real estate.

The UK had not before attempted to tax non-residents in this way, and this change received much negative comment. It is also widely seen as a precursor to the introduction of indirect SDLT, similar to the German real estate transfer tax, although no formal proposals for this have yet been announced. Rather, the focus in terms of new real estate taxes shifted to the residential property developer tax, introduced with effect from April 2022. This tax has the rather specific object of raising at least £2 billion over a 10-year period in order to fund the remediation of unsafe cladding in residential apartment blocks, a policy brought about following the Grenfell Tower tragedy of 2017 and the realisation that a number of apartment blocks in the UK were fitted with cladding, previously considered to be safe, that was now understood to present a fire hazard. It is in effect a surtax charged at 4 per cent (subject to a £25 million annual allowance) on the profits of businesses undertaking residential property development in the UK, whether for investment or sale.

One noteworthy fiscal response to the pandemic was the decision taken in the 2021 Budget to increase the UK's corporate tax rate from 19 to 25 per cent, which came into effect from April 2023. This represents a significant reversal of the policy first adopted by the last Labour government in 2007 of reducing the rate from its high point of 30 per cent – at that stage to 28 per cent – and further under the coalition and the current Conservative governments to its previous rate of 19 per cent.

V OUTLOOK

Recent events have confirmed that more than ever it is impossible to predict the future. Although it is clear that covid-19 in some shape or form will remain with us, political instability and economic uncertainty have taken over as the dominant forces affecting the UK real estate M&A and private equity markets. The UK has had three Prime Ministers over the past 12 months including Liz Truss's disastrous seven weeks in charge: the shortest tenure in British history. The country is desperate for a stable government capable of formulating and implementing sound economic policies. The ongoing war in Europe has demonstrated the fragility of world peace and also the complexity of global economics as countries seek to wean themselves off imported oil and gas, and other natural resources. Certainly, these events have demonstrated the folly of over-reliance on a particular commodity or source.

After a gloomy few years dominated by the covid-19 pandemic, war in Ukraine and alarming climate change events, it is sincerely hoped that next year's edition brings with it much more positive updates from the UK and the rest of the world. There is no shortage of investment capital waiting for a home and, after a quiet spell, pressure will mount on private equity firms to return to the negotiating table and bank some profitable deals. Opportunities are out there, helped by sellers moving towards buyers with a more realistic pricing of assets and the availability of creative funding options, including joint ventures. However, deal time frames are likely to remain longer, with deeper due diligence and protracted negotiations, and there is the prospect of an increase in M&A disputes. The importance of real estate as a global asset class is, however, a constant and it is expected that UK real estate markets will continue to prove resilient while adapting to rapidly changing demands.