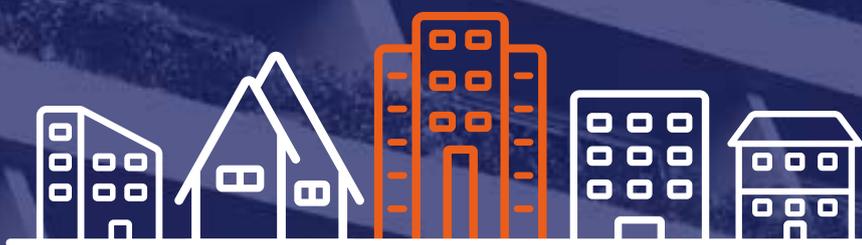


# UK REITs: why now?

Episode 2: laying the foundations



# Basics of the UK REIT

In our previous paper<sup>1</sup>, we considered the basic principles of the UK REIT regime and why historic changes to the REIT rules and prospective changes to the UK tax landscape have made REITs an increasingly attractive structure for investment in UK real estate.

In this paper, we discuss some of the further considerations in establishing a REIT, plus some less widely acknowledged processes and ongoing practicalities.

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<sup>1</sup> [www.eversheds-sutherland.com/documents/services/taxation/reits-paper1.pdf](http://www.eversheds-sutherland.com/documents/services/taxation/reits-paper1.pdf)

As early as possible, consideration should be given as to whether the particular business can work within the REIT rules. This should be modelled not only on Day 1, but also going forward, and should take account of the detail of the rules as well as the headline conditions. For example, the following questions might be asked:

- Is the income profile such that there will be sufficient cash to meet the 90% distribution test? Where, for example, there is debt in the structure, any debt amortisation will not be deductible in computing income profits
- Where Day 1 reliance is being made on certain grace period provisions, to assist start-ups, such as the “non-close” company or “actually traded” requirements, what steps, provisions, and timetabling are being put in place to ensure that these can be met within the relevant timescales?

It is important to identify any risk areas, and to put in place appropriate compliance procedures or other steps to ensure that they can be dealt with.

Apart from the documentary, tax, and regulatory requirements around launch of a REIT, there are other important commercial factors to take into account, particularly if the launch involves an IPO.

## Early stages

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First, it is key to establish as early as possible whether there is sufficient investor appetite for the particular REIT. Factors to be considered here will include:

- Target market: who is the REIT aimed at? Is there to be a cornerstone investor, or more than one? What is the investment strategy of the potential investors?
- Portfolio: does the company need to be seeded with an initial portfolio of a particular scale to offer a strong investment case? Investors can be reluctant to invest in “blind pools”, unless the investment case is particularly compelling;
- Proof of concept: is there sufficient interest in the target market for this type of investment on the desired scale?

- Board composition: as well as a strong day to day management team, choice of a suitable board, with appropriate skills, reputation and, increasingly, diversity will be important in attracting investors; and
- Book building: the broker will generally lead the book build to raise funds for the IPO and will be able to assist with the assessment of the market place, competition and other factors which could affect potential timing and pricing of launch, as well as other factors, such as whether it should be an institutional, retail or intermediaries offer.

Relevant advisors will also need to be appointed - albeit on conditional terms. For example a broker, sponsor/ nomad, lawyers, accountants, depository, administrators, and registrar should be instated as appropriate. Moreover, they may also be able to assist with the above.



# Practical considerations on becoming a **REIT**



**Having established that in principle, the REIT structure would be suitable for the business, there are then further practical steps to go through to get the company and group in the right shape. These can include some of the following:**

<b>The structure</b>	
<b>Corporate structure</b>	Can the company/ group simply convert to a REIT or does there need to be some restructuring? Does, for example, the principal company need to be converted to a plc? Does a new "Topco" need to be inserted? Are other changes required to the capital, group or tax structure? Check that the company is not open-ended.
<b>Choice of jurisdiction for the principal company and subsidiaries</b>	REIT requirements, company law (such as around distributions), listing rules, costs, practicalities, and investor preference will all be relevant requirements. Tax and legal advice on the structure of the REIT will include not only advice regarding the residency of the principal company, but also in relation to its subsidiaries and any other intermediary or asset holding entities. The proposed tax changes to CGT from April 2019 and extension of corporation tax to non-resident corporate landlords ("NRCLs") from April 2020 may be relevant to the decision, alongside the disclosure of certain beneficial interests in non-resident companies from 2020.
<b>Choice of stock exchange</b>	This will depend not only on the REIT requirements but on other practical factors, such as the targeted investor base, desired trading liquidity post IPO, level of regulation and compliance (both to get to IPO and, post-IPO, on an ongoing basis), admission and eligibility requirements of the relevant exchange/market and ongoing administration, speed, and cost. If the REIT is to be launched as an IPO, is this to be in London (and, if so, would it be on the Main Market as either a premium or a standard listing, AIM or the Specialist Funds Market)? If not, what other non-UK, but HMRC-recognised exchange would be appropriate? What are the drivers and considerations in the relative merits of each? A popular non-UK choice at present, particularly for those REITs with institutional investors not seeking immediate liquidity, is The International Stock Exchange (formerly the Channel Islands Stock Exchange, in Guernsey).
<b>Regulatory</b>	
<b>Are all regulatory requirements in place?</b>	Will the REIT be an alternative investment fund ("AIF") under the EU's Alternative Investment Fund Managers Directive and if so, will the manager be required to be regulated and to appoint a depositary and how will this affect or be driven by the REIT's marketing strategy? Could a "host AIFM" be appointed as a short or medium term solution? Any relevant steps should be built into the timetable.
<b>Property rental business ("PRB")</b>	
<b>Identification of PRB assets</b>	Not all assets of the REIT will necessarily be in the PRB. Those assets that are to be part of the PRB (exempt business) of the REIT will need to be identified separately from those of the residual (taxable) business. Different tax rules will apply to the PRB assets from entry into the regime.
<b>Property valuations</b>	Market valuations of the PRB assets will be required on entry to the regime. Although there is no tax charge on any upward rebasing of the bare costs of PRB assets on entry and the REIT should be tax exempt on any subsequent gains from disposals of assets of the PRB, there are certain circumstances when the entry rebasing provisions may be disapplied. Accordingly, information on the historic position, as well as the revaluation should be ascertained and retained.

**Compliance**

<p><b>Establishment of systems, and compliance procedures</b></p>	<p>Systems will need to be put in place to deal with:</p> <ul style="list-style-type: none"> <li>• Governance, including the appointment of appropriate directors, establishment of the relevant board committees, adoption of policies and procedures (see “Disclosure and ongoing obligations” below) and if quoted on AIM, the choice of an appropriated corporate governance code (the UK Corporate Governance Code will automatically apply to companies included in the FTSE350)</li> <li>• Appointing a Nomad/Sponsor, if required</li> <li>• Including an investor relations section on the REIT’s website, which complies with the Disclosure and Transparency Rules/AIM Rules</li> <li>• The appointment of a registrar to maintain the register of shareholders on an ongoing basis</li> <li>• Bank accounts, which will need to be opened in good time if this a start-up</li> <li>• Information as to whether investors would be entitled to gross payments of property income distributions (“PIDs”) or only net payments</li> <li>• Distributions and vouchers</li> <li>• REIT financial statements</li> <li>• Tax filings</li> </ul>
<p><b>Investor considerations</b></p>	<p>The position of particular investors in relation to the REIT rules should be checked, identifying those who may be impacted by the 10% corporate shareholder restriction, and appropriate ways to work with it. Corporate documentation should be drafted to ensure that potential tax fines in the REIT for inadvertent breaches of this provision are avoided, as well as making provision in relation to gross and net payments more generally.</p> <p>As part of marketing, it may be helpful to identify those investors who may be able to make double tax treaty claims to reduce or eliminate their effective UK tax leakage. This could make their investment more attractive, where appropriate.</p>
<p><b>Disclosure and ongoing obligations</b></p>	<p>The REIT will have to make initial disclosures regarding its business strategy, investments, and other resources in the prospectus (for main market companies) or admission document (for AIM companies) relating to its IPO. Either document will include a set of risk factors relating to the REIT, its business, and the industry in which it operates.</p> <p>The REIT will need to announce major events affecting its business as they happen and will have to report on its business as a whole, on a half-yearly basis. In addition, transactions above a certain size will require shareholder approval.</p> <p>The REIT will have to manage inside information and close periods appropriately, to avoid insider trading offences.</p> <p>The REIT will become subject to the City Code on Takeovers and Mergers, which means that shareholders who alone, or in concert with others, acquire 30% or more of the shares in the REIT will be required to make an offer for the entire issued share capital of the REIT.</p>

# Onshoring

We are anticipating that many offshore companies and other entities will consider converting to REIT status over the next few years. This is not solely due to the proposed changes to the UK taxation of gains of offshore investors and the extension of corporation tax to NRCLs, but we expect that they will cause a significant increase in uptake.

There are several issues to consider where onshoring, but a key one for compliance with the REIT rules, is UK sole residence and how to ensure that this condition is met, in particular following conversion from an offshore entity. Whilst the principal company of a UK REIT must be tax resident in the UK, it does not need to be a UK incorporated company. In fact, a UK REIT could be incorporated anywhere in the world provided that it is UK tax resident only.

Importantly, subsidiary vehicles in a REIT do not have to be UK tax resident and under the current law for some there may be various advantages to these being in the structure. However given the changing status quo the position should be reviewed, not only for companies but also in particular for those vehicles which are not companies in form, such as offshore property unit trusts (eg JPUTs) to ensure that the tax treatment remains as expected.

In looking at whether and how an offshore company should meet the UK residency test, the factual matrix will be important. This may differ depending on the management model and on the jurisdiction of incorporation, as well as the terms of any relevant double tax treaty. At its simplest, it may be possible to satisfy the REIT tax residency test by appointing a UK board and retiring the existing board. However, it should always be checked whether this is actually enough or whether further or different steps are required.

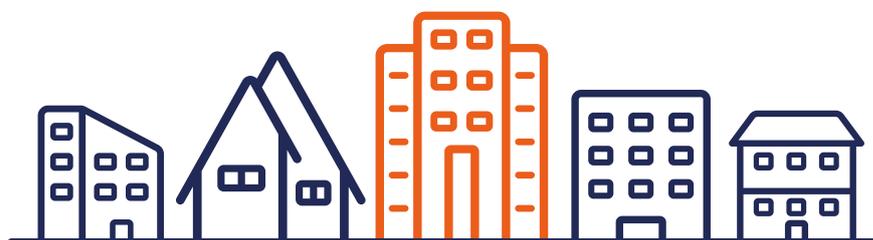
# Post Entry

The REIT rules need to be complied with on an ongoing basis and systems should be put in place to ensure general compliance and to flag any aspects which may need particular care.

Dividend policy and its interaction with the distribution and attribution of profits rules, the shadow capital allowances regime, relevant elections under the new corporate interest restriction rules, financial statements and tax returns will all need to be dealt with.

# Moving forward

Whilst this briefing and Episode 1 indicates that there is much to consider, the REIT has many benefits for the right business model and investor base. It is likely only to increase in popularity as an appropriate investment vehicle in the UK, as it has already done for real estate investment in other jurisdictions.



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