

Commercial Property Acquisition Structures

Introduction

This article considers the structure for acquisitions, and investments in, commercial property assets. The focus of the article is on tax, regulatory, corporate and property issues.

Our conclusion is that in this market the focus should be to keep the structure of the acquisition and funding simple.

Tax

Once you, as buyer, have identified the asset, the next step is to think about the most appropriate wrapper in which to hold that asset. The tax and structural considerations need to be balanced between the short-term (being the cost of acquisition) and the long-term strategy (being your exit from the investment), namely:

- What are the reasons for acquiring the property? Is it to derive a long term rental/income stream, is it to sell the asset on to derive capital value or is it to develop the property before its onward sale?
- What do you intend to do with the sale proceeds on exit? If the profits are going to be re-invested then a corporate vehicle will usually be the better vehicle in which to hold the property.
- Where do you see the risks in holding the property? If you perceive that there is a risk on the site or in its development then a limited company is still seen as having more clear and defined limits on liability than within a limited liability partnership (LLP) structure (despite the limited liability of LLPs).
- Tax (including stamp duty land tax). Currently the acquisition and onward sale of commercial property through a corporate vehicle would still be the most efficient to mitigate against the SDLT charges on an exit.

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Regulatory

Regulatory issues will apply if the acquisition is being funded by either equity or debt investment other than from wholesale (i.e. bank) debt. Advice should be sought at the outset around this increasingly regulated area and factored in to the structure and timing of the acquisition.

Important regulatory points to note are:

- Offers or opportunities to make investments into the acquisition vehicle will be subject to the financial promotion restrictions under the Financial Services and Markets Act 2000 (FSMA) and related legislation.
- There are exemptions to these restrictions and two of those most commonly used are to ensure that the recipient of the offer is a certified high net worth (individual or company) or sophisticated investor. In order that they are available, strict conditions will need to be complied with when relying on these exemptions.
- There are also specific restrictions on the promotion of collective investment schemes (CIS). A CIS is an entity or scheme where (i) it is an arrangement regarding property (including money) (ii) in order to enable the participants to receive income/profits and (iii) the participants' contributions and profits are pooled or the property is managed as a whole. A CIS must be operated by an authorised person under FSMA. This will have regulatory, timing and cost issues. Without an authorised manager it is a criminal offence for an unauthorised person to set up or operate a CIS and the investment agreement may be determined as unenforceable. It may also be criminal offence for an unauthorised person to improperly communicate a financial promotion, and any arrangements entered into as a consequence of that promotion may be determined as unenforceable.
- Importantly there is an exemption for limited companies, but not for limited partnerships or LLPs. Therefore specific CIS promotion restrictions will be relevant if you are considering investment through a limited partnership or LLP. An LLP will not be deemed to be a CIS if the investors have day to day control over the management of the property. Careful analysis of whether this would apply to a particular investment will be needed as management through veto rights or investor representative rights under the terms of a LLP agreement is now unlikely to satisfy this "management on the ground" requirement.

- The regulatory burden is likely to increase as the FCA focuses on the marketing of sophisticated investments to retail clients. The FCA has already signalled that it intends to severely restrict the promotion of unregulated CISs (which the majority of property CISs are) to retail clients – broadly speaking, anyone who is not a high net worth individual or company, or a financial professional.
- The impact of the Alternative Investment Fund Managers Directive (AIFMD) may also need to be considered in respect of unregulated property CISs. These rules, to be implemented in the UK in July 2013, will significantly increase the regulatory burden for many property CIS operators.

Corporate

If you are looking for investment in order to fund the acquisition, whether through a company or LLP vehicle, it is important to ensure that the expectations of the investors are clearly aligned and the investment terms are clearly set out whether within a company's articles of association, an LLP agreement or an investment agreement. An advantage of investing through an LLP structure is that the investors have significantly greater flexibility in distinguishing between their rights and obligations. In particular in focusing on equity/capital growth, income return and control issues:

- **Equity:** a company requires different classes of shares to distinguish between members rights with UK company law incorporating fairly onerous maintenance of capital requirements. An LLP, on the other hand, can distinguish between particular members or classes of members in the distribution of capital profits.
- **Income:** within a company structure rights to return on capital and income/dividend rights are more often than not aligned so that a preferred shareholder receives a priority return on both. An LLP can split the capital and income profits so a member can receive different proportions of an LLP's return on capital and income.
- **Control:** a company's constitution either needs to distinguish between and set out the different share rights or a separate investment agreement needs to provide for such matters - for example the appointment of representatives to the board or setting out the matters which require investor consent. A LLP agreement can be more flexible than this and can distinguish between voting and non-voting members and their voting entitlements and it can also incorporate a management board to represent members interests.

As the law for LLPs develops, the LLP agreement is also evolving with the adoption of corporate principles within it. This can include the ability to transfer a member's "interests" in a LLP (such as drag and tag rights) and the ability to incentive the managers of the asset through different interest classes.

Property

Whether acquiring the property through a company, LLP or other vehicle, property due diligence, valuation and pricing all apply as with any property acquisition.

Importantly however, the parties involved (whether seller, buyer, investor, debt funder or any potential buyer on an exit) will need to understand the characteristics, rights and obligations of the vehicle being used. For example if an investor is off-shore and is not familiar with equivalent entities with in their jurisdiction then you may choose to defer to a traditional corporate vehicle.

Conclusion

We believe that there are investment opportunities presenting themselves for 2013 in the UK commercial property market. The key drivers are twofold: (i) to ensure that the valuation is robust and (ii) to keep the structure as simple as possible in order to implement the acquisition as quickly and effectively and to plan, ultimately, for a successful exit and return on capital.

If you require further information on anything covered in this briefing please contact Larry Phillips, Graeme Blair or your usual contact at Goodman Jones on 020 7388 2444.

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