GT GreenbergTraurig

London Real Estate Practice
Quarterly Update for Overseas Investors | Summer 2020

Introduction

Welcome to Greenberg Traurig's Quarterly Update for Overseas Investors, prepared by the firm's London Real Estate Practice. This newsletter reviews a range of legal and practice developments that may directly affect overseas investors in the UK real estate sector.

Beneficial Ownership Register

The UK government has announced its plan to introduce a new register of beneficial owners of UK properties owned by overseas companies and legal entities.

Beneficial ownership refers to the person who ultimately owns, controls and benefits from an asset. This is not necessarily the direct legal owner. Registers of beneficial ownership already exist (or are being created) in many countries, with the aim of providing transparency and guarding against corruption, tax evasion and money laundering. The UK itself already operates beneficial ownership registers, whereby beneficial ownership information is publicly available, in respect of companies, properties and land (where the legal owner is a UK company) and trusts.

Pursuant to the draft Registration of Overseas Entities Bill, an overseas entity would have to provide information about itself and its beneficial owners to Companies House and would not be able to buy, sell, charge or grant leases (over seven years) of UK property without doing so. Existing overseas owners would need to apply for a registration number within 18 months of the legislation being introduced. Information would need to be updated annually until (if applicable) the entity successfully applies to be removed from the register. There would be criminal penalties for non-compliance.

Despite no obvious progress on the draft bill as yet this year, following legislation introduced in January in respect of the EU's Fifth Anti-Money Laundering Directive, the register may become operational in 2021.

Commercial Leasing & the 'New Normal'

Coronavirus Disease 2019 (COVID-19) has forced many commercial owners and occupiers to revisit the rights and obligations they have under their existing leases.

Rent suspension

Modern commercial leases do not usually include *'force majeure'* provisions, whereby a party is relieved from the performance of its contractual obligations, such as the payment of rent, due to the occurrence of an event beyond the reasonable control of that party.

Absent such a clause, rent is generally suspended only if an occupier cannot use (or access) its premises due to physical damage caused by an insured risk, for example, fire. As a result of the current pandemic, occupiers may now try to negotiate rent suspensions triggered by the occurrence of a '*force majeure'* event – specifically government-imposed restrictions requiring the closure of premises due to COVID-19 or a general pandemic.

Termination

A lease cannot be terminated early, save where there is a contractual break clause permitting the same (subject to the satisfaction of any specified conditions) or the owner exercises its right of forfeiture and terminates following an occupier breach, for example, non-payment of rent.

Pursuant to temporary UK legislation, an owner cannot currently exercise its right of forfeiture for non-payment of rent. Occupiers could seek to replicate this contractually such that they are protected even if this legislation is revoked. Alternatively, occupiers may seek to negotiate more flexible break clauses, operable at any time, especially if they cannot rely on the protection of a widely drafted rent suspension mechanism and/or a restriction on the owner's right to forfeit.

Services

In multi-let buildings, owners will typically charge occupiers a service charge, in addition to the annual rent, allowing an owner to recover the costs it incurs in managing the building, for example, cleaning common parts. As a result of COVID-19, owners must now comply with additional obligations in terms of social distancing and community hygiene, to ensure the safety of their occupiers and anyone else accessing their buildings. Owners will want to ensure that the increased costs of any additional cleaning and other services are recoverable from their occupiers.

Lenders

Any new or amended lease clauses, that could potentially interrupt the flow of income for a landlord, should be considered carefully with any lenders.

COVID-19

- Temporary legislation provides that commercial owners cannot forfeit leases for non-payment of rent (*section 82, Coronavirus Act 2020*). This protection, for '*relevant business tenants',* is in place until 30 September 2020, following which an owner's right to forfeit will become operable again. Note: this is not a suspension of an occupier's obligation to pay rent.
- Restrictions on the use of Commercial Rent Arrears Recovery (CRAR) have also been extended until 30 September. CRAR is a statutory procedure whereby commercial owners can take control of an occupier's goods to recover rent arrears.
- There are currently no statutory restrictions on commercial owners seeking to recover rent arrears from occupiers pursuant to the terms of an existing rent deposit or guarantee.
- The UK government published its voluntary code of practice to encourage commercial owners and occupiers to work together to protect viable businesses. Occupiers are encouraged, if able, to pay their rent in full whilst acknowledging that owners should, if able, provide support to businesses. The Crown Estate, for example, has offered turnover-linked rents to some of its retail and restaurant tenants to attempt to help them through the pandemic.
- In an article published by PERE, GT Shareholder Steven Cowins and three UK managers examine how compromise is the key for private real estate amid the COVID-19 pandemic. GT also assesses some of the new obligations on, and additional considerations for, commercial owners and occupiers when reopening their businesses post-lockdown.

Insolvency

The Corporate Insolvency & Governance Act 2020 came into force on 26 June. For the real estate sector, the most notable provisions include:

- restriction on the presentation of winding-up petitions (on or after 27 April) based on all statutory demands served between 1 March and 30 September. A creditor who is owed more than £750 can apply to the court to wind up a company if the company cannot pay its debts and the creditor can prove this. A statutory demand is simply a formal way of a creditor asking for a debt to be paid.
- creditors can only present winding-up petitions (from 27 April to 30 September) if they reasonably believe COVID-19 has had no financial effect on the company, or insolvency would have arisen in any event and irrespective of COVID-19. To grant a petition, the court needs to be similarly satisfied.
- a new moratorium procedure has been introduced for eligible entities which prevents creditors from taking enforcement action and allows a company time to implement a rescue plan. The moratorium applies for an initial 20-day period, unless extended. The company is entitled to a payment holiday on '*pre-moratorium*' debts, and there is a prohibition on the enforcement of security, commencement of insolvency proceedings and other legal proceedings, including forfeiture of a lease by a landlord. Any new debts falling due during the moratorium must be paid.
- ban on the termination of any '*contract for the supply of goods and services*' (not defined) due to a party becoming insolvent. A lease, the main aim of which is to create a proprietary interest, would may not be included; however, agreements, for example, in respect of serviced offices, could well be.

New UK Tax Landscape for International Investors

Over the last few years, the UK tax rules for overseas investors in UK real estate have seen significant changes. GT's Clive Jones and Jessica Ganagasegaran highlight some of the changes and some of the steps that may be considered to potentially mitigate the impact of these changes.

Tax Treatment of Asset Holding Companies in Alternative Fund Structures

Holding companies for real estate assets are often established outside the UK. The advantages of doing this for UK real estate assets have been eroded by the changes to taxation of capital gains introduced last year and the changes to the taxation of rental income which took effect from 6 April. However, where non-UK real estate assets are concerned it is usually advantageous to hold them through non-UK vehicles, particularly for non-UK or tax-exempt investors.

The UK government has issued a consultation document to improve its understanding of the use of holding companies in fund structures; to explore how the UK tax system acts as a barrier to their formation in the UK; the merits of reforming UK tax rules to remove those barriers and what options might be available to achieve that. Comments were due by 19 August.

Stamp Duty Land Tax (SDLT)

A new 2% SDLT surcharge on non-UK residents acquiring residential property in England and Northern Ireland is to be introduced from 1 April 2021 (special rules apply in respect of transactions where contracts are exchanged before 1 April 2021 but are not substantially performed and/or completed until that date or later).

The surcharge will affect asset unit and portfolio acquisitions (both freehold and leasehold). Where six or more units are being acquired, the existing choice remains as to whether to apply residential rates and claim multiple dwellings relief (MDR), or whether to apply commercial rates. However, the application of commercial rates (rather than claim MDR) may be more beneficial on smaller transactions than would have been the case previously.

The acquisition of bare and/or commercial land for redevelopment on the way in will not be affected nor will share and unit transactions. With the latter, due to unrelated SDLT case law, care may need to be taken if it is proposed to extract the asset from the company or JPUT after acquisition.

Turnover Rents Return

UK commercial leases typically provide for a fixed, reviewable rent linked to either open market value or a price index. Post-COVID-19, turnover rents are being mooted as a way for owners and occupiers to spread the risk by sharing in the successes and downsides of an occupier's trading performance.

Turnover rents are typically calculated by reference to a percentage of the gross turnover generated by the occupier at the premises, over and above a guaranteed minimum base rent linked to either open market value or a price index and reviewable throughout the lease term. An occupier would still be expected to pay for insurance; service charge and rates and utilities, over and above the turnover rent.

Gross turnover will be carefully defined to reflect the occupier's business and include and exclude certain elements, for example, the inclusion of '*click & collect*' and the exclusion of VAT. At the end of each turnover period, the occupier will provide an audited turnover certificate to the owner, certifying the

amount of gross turnover for that period. In advance of this, an owner will typically require the payment of an on account turnover rent estimate which is then reconciled against actual gross turnover. This is to protect the owner against late payments of turnover rent due to delays or disputes regarding the turnover certificate.

If the premises are closed for a long period, the owner will typically provide for either a fixed daily sum to be payable or a turnover rent based on the equivalent gross turnover for the equivalent days during a previous turnover period.

At a time where many owners and occupiers have already been forced to negotiate rent concessions in the form of monthly rents; deferrals; reductions and holidays, turnover rents have also been adopted by certain UK owners to help tenants, particularly in certain sectors such as retail.

* *This GT Newsletter is limited to non-U.S. matters and law.*

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