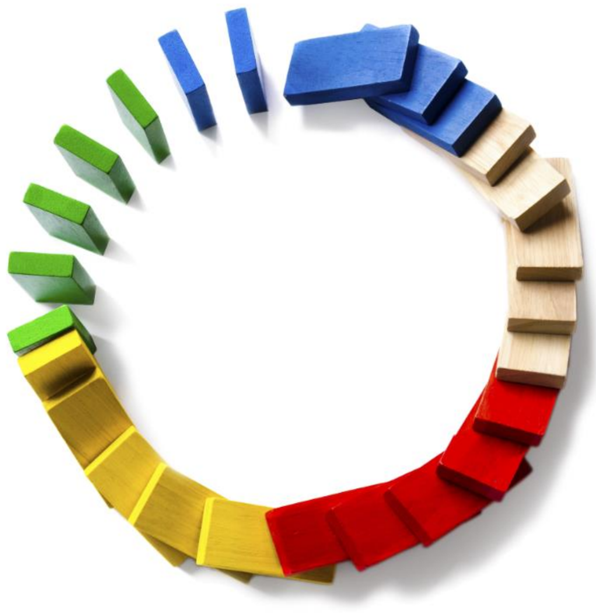
Real Estate news from Deloitte
March 2021



Real Estate Newsletter

This real estate newsletter aims to provide more insights on various topics. We kick off with a first hot topic on alternative real estate financing in the context of COVID-19 and the various forms that we see in the market. Secondly, we will provide more information on so-called historical split ownership structures ("tréfonds"/"naakte eigendom"/"bare property" versus "droit d'emphytéose"/"recht van erfpacht"/"leasehold right") and the current position of the Ruling Commission/Vlabel in case of a reconstitution of the full ownership based on capita selecta. Finally, we will zoom in on a new aid measure introduced by the Brussels Region on 17 December 2020 to support companies to pay the rent of their commercial premises.

Real estate financing in the context of COVID-19

Real Estate Financing is undergoing a significant transition. More than ever, developers and investors are having to be creative to cover their projects' financial needs. Next to the banks, newly interested investors are coming up, partially taking over the bank's role. Equity partnerships and hybrid funding solutions appear to be the trend since Real Estate is still proposing an interesting risk-return trade-off.

The European economic environment experienced a GDP contraction of 6.2% (in Belgium) in 2020, versus an increase of 1.7% the previous year. Inflation suffered as well due to the crisis. The 2020 inflation rate amounted to 0.4% in Belgium, a severe contraction compared with the 1.2% of 2019. Unemployment rates have soared and are predicted to reach 7.4% in 2021, set against 5.6% in 2020 and 5.4% in 2019. Since 2009, we have been experiencing a continuous decline in interest rates, with the 10-year OLO in Belgium reaching the 0% threshold in July 2019. On 15 December 2020, the 10-year OLO even fell to -0.40%1.

Overall, the combination of negative GDP growth and low inflation has kept interest rates low. This interest rate environment, however, supports real estate investments.

The prudential rules that apply to real estate loans affect the bank's profitability directly as they require an additional effort on Tier 1 & Tier 2 capital. These regulations lead to an additional cost charged on top of the customer's credit margin. Loans are therefore issued only for projects/investments with the best risk-return trade-off. In addition, the banks' lending policies are geared toward clients with whom they can generate an additional return through side-business.

Banks are tightening the granting of loans for real estate, leaving some sectors without financing. The attractiveness for real estate financing, however, is not the same for all asset classes.

Land positions requiring a zoning change are not financed anymore. Pre-permit development financing has become very difficult, while "lands with a permit" can still be funded at an LTV rate between 55 and 70%.

For **residential real estate**, we observe a shift in a fringe of the population that is moving from buying to renting as a consequence of the banks' equity capital requirements for granting mortgage loans to individuals; this has led to the emergence of new creditworthy tenants, resulting moreover in increasing interest of institutional investors in residential real estate. However, the banks' appetite for financing residential developments depends both on the quality and state of progress of the development, with greater attention paid also to the borrower's creditworthiness. For qualitative and permitted projects, the requirements in pre-sales (min. 15% to 25%) and equity (15%) have not changed substantially. However, according to the banks, very few or no waivers on these condition precedents shall be accepted. The cost for residential funding currently amounts to 150-170 bps which is a significant step-up compared to 115-135 bps 5-6 years ago.

The office sector must cope with vacancy risks and new trends considering the space per worker and remote working. These changes in office property are less likely to affect institutional and public tenants. The gap between Core assets with LT leases and Value-Add acquisitions will thus result in larger yield spreads.

Core(+) investments still get financing for office buildings with a long-term lease with a public authority at 120 base points ('bps') credit margins. Multitenant leased office assets with a Weighted Average Lease Term ('WALT') of a minimum of 4 to 5 years can also be financed if the building is less than ten years' old and has a Loan to Rent ('LTR') ratio of 8 to 12 (14 for well-located and well-leased assets). For the latter, credit margin typically amounts to 200 bps. Banks are ready to finance office assets at a Loan to Value ('LTV') ratio of up to 65%, which must be phased over ten years to an LTV of 45%-50%.

The attractiveness for **retail** has decreased due to lower turnovers. In the short term, an increase in yields is expected except for specific retailers such as supermarkets, garden centers and DIY shops that show remarkable resilience. Retail development (excluding COVID-19 resilient activities) and hotels are no longer within banks' lending policies. However, properties with high occupancy rates (>80%) are still financed with an LTV ratio of 50% to 70% for the most attractive retail sectors.

Due to the strong resilience of **Logistic real estate**, new partnerships between Institutional investors and Logistic developers are emerging, demonstrating a strong interest in this asset class. Pre-leased and permitted logistic developments are funded at a 70% to 80% Loan to Cost ('LTC') ratio. For investment financing, the LTV is close to 55% or 60% for logistics and high-quality industrial assets, with a financing period of up to 15 years. Credit margins for Logistic assets can go to 125 bps.

Infrastructure and public buildings are overfunded due to a public debtor's guaranteed cash flow, causing profit margins to be meager.

In the current sanitary crisis, it is the principle of "project-based financing" that is being challenged since projects will often only

[1] NBB February 2021

receive finance if corporate/public guarantees are offered to the benefit of the lenders in addition to the underlying collateral.

Developers thus need to raise more capital to fill in the equity gap to realise their projects, and more specifically, in the pre-permit phase. Moreover, players in the most resilient sectors may want to raise money to sustain their activities' growth and consider the evolution of their strategy towards a more hybrid business model combining development and long-term investment.

Third-party equity funding is increasingly considered by developers willing to share the projects' benefits, mostly compensated by higher project management fees for the developer resulting in a lower ROI. However, banks do not feel comfortable with high management fees, which ultimately comes down to an equity release bypassing senior debt priority.

Mezzanine financing is becoming popular through crowdfunding platforms offering an additional funding solution for small and medium-sized real estate developments. Rates typically rank between 6% and 8%, with security packages comparable to senior lending.

While banks could currently be reluctant to commit to real estate financing, institutional investors seem to be much greedier. In search of high returns, insurance companies are now ready to take the developer's risk in addition to the investment return. Traditionally focused on office real estate, institutional investors are now interested in other asset classes, such as residential and logistics. KBC Insurance recently acquired the Condor in Ostend and Swiss Life REIM acquired the Vaartkom in Leuven.

Although the growing appetite of institutional investors meets developers' working capital needs, in such partnerships, the financing issue however remains a challenge, with investors often preferring limited financial leverage as opposed to developers. Hence, private equity funds and family offices can be an interesting alternative to bridge the equity gap, helping developers fulfil the senior lending requirements. Debt funds and ISPs (Alternative Investment Funds) can provide whole loans, mezzanine loans or a combination of both. These alternative providers mainly originate from outside Belgium and require, in most cases, a minimum investment size of EUR 15-20m. Their financing cost is benchmarked internationally, making them relatively costly funding providers with mezzanine loans often going towards double-digit numbers. Additional funding sources with, amongst others, Private Placement Bonds, Public Bonds and Green Bonds, can be considered.

Each of these strategic options needs to be assessed in the light of eligibility and investment criteria, constraints and regulations. The real estate financing landscape is definitely more challenging and selective but alternatives are increasingly available. It will be crucial to target the type of funders whose strategy and investment/lending criteria matches with the "real estate product" to be financed.

We strongly believe that the transition to alternative funding solutions is essential to make real estate a resilient industry in a fast-changing economic environment. Innovating projects need money and money is available. The trick is to structure the right partnership in the appropriate format.

Split sale transactions: overview and capita selecta of recent positive ruling decisions with respect to reconstitutions of full ownership

More and more, we are confronted with divestments of so-called historical "split sale" structures (i.e. split acquisition of long leasehold and bare ownership of a property) that used to be common practice on the Belgian real estate market until 2012. In this contribution, we will first briefly come back on the reasons why many acquisitions have been set up in the past using a split structure and on the evolution of the Belgian ruling commission/VLABEL's position in that regard. In addition, we will analyse how the entrance of the new general anti abuse rule ("GAAR") put an end to such structures and discuss the unwinding of existing split ownership structures. Finally, we will share with you some examples of 'successful' reconstitutions of full ownership on the market.

1. Origin of split sale transactions

"Split sale" transactions emerged in the early 2000s and became common practice in the Belgian real estate sector. The structure entailed the acquisition of a leasehold with regard to the property by a company A belonging to the Purchaser group, soon thereafter followed by the acquisition of the bare ownership of the same property ('freehold') by company B of the same group.

A split sale transaction allowed an important tax saving. In Belgium, the transfer of immovable property in full ownership is subject to 12,5% registration duties in the Brussels and Walloon regions respectively and 10% in the Flemish region. The sale of a long leasehold right only triggers 2% (previously 0,2%) registration duties, whereby the freehold's sale remains subject to 12,5% / 10% registration duties.

Given the relative weight of the value of the long leasehold right, a split sale *de facto* leads to a considerable real estate transfer tax saving.

2. Ruling commission practice on split sales

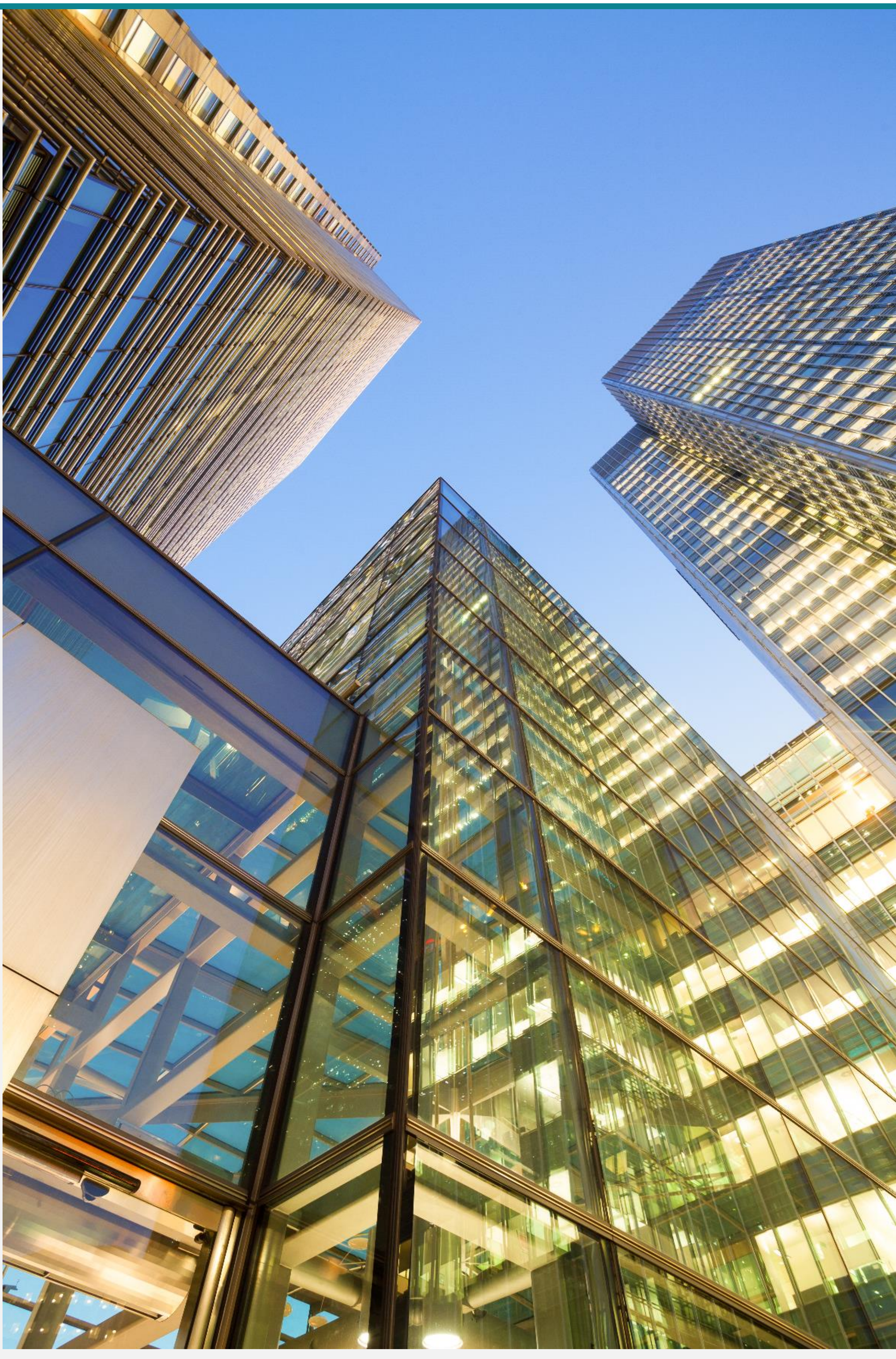
As from 2005-2006, a ruling practice was developed by the Belgian ruling commission allowing these structures insofar the following conditions were met:

- a minimum period of 15 days was respected between the establishment of the long lease right and the acquisition of the freehold; and
- the value of the long lease right (one-off canon) did not exceed 95% of the value of the property.

If the split sale transaction was entered into by related companies, the Belgian ruling commission requested the following additional commitments in order to issue a favourable ruling:

- The long lease right and the residual property right could not be re-united during the long lease period, except in the hands of a third party and provided that 10% or 12,5% transfer taxes are applied on the entire market value of the property;
- In the five years following the split-sale transaction, the companies should not be subject to a change of control in the sense of the Belgian Companies Code; and
- The same directors should not have a majority in the Board of Directors of the company holding the long lease right and the freehold company during the long lease period. Furthermore, none of the same directors can have the power to legally bind both companies during the long lease period.

Taking advantage of the favourable climate for this type of operations, many taxpayers also entered into split sale transactions by respecting those conditions *without* securing the related tax aspects in advance (via a ruling procedure).



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3. Entry into force of New GAAR and interruption of split sale practice

In 2012, a new version of the General Anti Abuse Rule (‘GAAR’) was introduced, giving more weight to the objectives of the legislator, to identify abusive practices.

Pursuant hereto, the Central Tax Administration issued a position explicitly pointing out split acquisitions by companies belonging to the same group as tax abusive transactions (these types of transactions were included in the so-called black list).

Upon lack of counterproof by the taxpayer, the new GAAR authorises the tax authorities to disregard a split sale transaction in a group context and tax the transaction as a simple transfer of the full ownership title. This requalification may trigger additional registration duties and (potential) late payment penalties.

Note however that split sales between independent parties are not targeted by the above position and remain therefore in principle allowed.

The introduction of the new GAAR also questioned the tax treatment of the unwinding of existing split ownership structures (set up under the scope of the old GAAR and depending on whether a ruling was obtained). In this respect, the (federal) Ruling Commission’s position and VLABEL’s (Flemish tax administration) position differ.

Federal Ruling Commission

Notwithstanding the condition imposed in the former rulings to apply the 10% or 12,5% on the full property value in case of a reconstitution, the Ruling Commission approved on several occasions (and still does today), that 2%of the 10% or 12,5% could be applied on the sale of the long leasehold freehold rights provided the full ownership reconstitution occurs in the hands of a third party investor (individual or company).

It should be noted that in order to obtain a positive ruling in relation to the reconstitution at the aforementioned rates, our experience shows that such reconstitutions must occur at the first possible occasion (meaning upon the first sale to a third party; which entails e.g. that the shares in the leasehold and freehold companies have not yet been transferred to another group).

For existing constructions that had benefited from a positive ruling in which parties agreed not to reconstitute the full ownership at an earlier date, the Ruling Commission also approved that the re-constitution may not jeopardise the previously granted ruling.

Flemish Tax administration – VLABEL

Since 1 January 2015 the competent authority with respect to Flemish registration duties (a.o. the transfer tax of 10%; the (leasehold) transfer tax of 2% still being a federal matter) is the Flemish Tax service (i.e. Vlaamse Belastingdienst or “VLABEL”). As from 2019 onwards, VLABEL also took the position that reconstitutions can occur by applying 10% on the market value of the freehold only. It however makes two reservations:

- the position shall not prevent the GAAR from still being potentially applied in relation to the reconstitution of such structures; and
- in relation to split acquisitions for which a favourable ruling was issued by the federal Ruling Commission in the past, and whereby the commitment was taken not to reconstitute the full ownership before the end of the leasehold, VLABEL shall (in consultation with the federal Ruling Commission) examine whether the registration duties applied on the initial transaction should be revised.

4. Some examples of reconstitutions of full ownership

Today the (federal) Ruling Commission and VLABEL validate on a regular basis the application of 2% on the sale of the leasehold by one company and the 10% or 12,5% by another company upon reconstitution of the full ownership in the hands of a third-party (i.e. “classic” reconstitution) and confirm that such transaction does not constitute tax abuse.

However, in practice, a wider variety of full ownership reconstitution cases are submitted to the Ruling Commission/VLABEL for validation apart from the classic structures. We have listed some examples of more exceptional reconstitution cases where the exit from the split structure was not considered abusive:

Case 1 – share deal of leasehold company followed by an asset deal of the freehold to the leasehold company (Ruling Commission)

Case 2 – reconstitution of full ownership in the same group (Ruling Commission)

This case did not address a reconstitution of the full property in the hands of a third party but in the hands of the leasehold company itself, which is contrary to the current reconstitution ruling practice (cf. reconstitution in the hands of a third party). The Ruling Commission nevertheless issued a favourable ruling confirming that the transfer of the freehold could occur at 12,5% on the sales price/market value of the freehold (the leasehold itself was not transferred as the shares in the leasehold company were transferred). The main reasons for this rather exceptional position was the fact that (i) the leasehold company performed important operational activities, was involved in many contracts and employed a substantial number of staff for which the continuity was to be preserved and (ii) the freehold was transferred to the leasehold company *after* the transfer of shares of the leasehold company to the third party.

This case dealt with a reconstitution of the full ownership of the property in the hands of a company which was part of the same group as the leasehold company and the freehold company. According to the Ruling Commission, a reconstitution of the full property within the same group can in principle only occur if 12,5% is paid over the higher of the market value or the sales price of the full property. However, as the split structure of the leasehold versus freehold in the group was not the result of a classic split acquisition in the past, the Ruling Commission agreed that such reconstitution could be performed at 2% on the market value/sales price of the leasehold respectively 12,5% on the market value/sales price of the freehold.

Case 3 – preservation of existing split ownership structure (VLABEL)

This ruling was issued by Vlabel and relates to the indirect (split) sale of the full property (over time) to a third party group, whereby (i) the former leasehold company was transferred to the third party after having performed a refinancing operation (i.e. a bank took over the leasehold and the obligations under the leasehold and rented the property back to the former leasehold company) and (ii) the freehold of the property was transferred to another company of the third party group. Given the specific context of the transaction and the fact that the split ownership did not result from a historical split acquisition of the leasehold and freehold by the same group, VLABEL confirmed that the transfer of the freehold could occur at 10% on the market value of the freehold

Case 4 – sale of a leasehold right by a financial institution (VLABEL)

In this specific case, the leasehold right was initially acquired by a financial institution in the context of a financial leasing operation. Around the same period, the freehold was acquired by a third party. After a few years, the lessee and the owner of the freehold entered into discussions with a third party which wanted to acquire the full property title. As the financial leasing was terminated early, the remaining lease payments and an indemnity had to be paid to the financial institution (the surplus remained for the benefit of the lessee). VLABEL confirmed that such a reconstitution was not abusive and that 10% could be applied on the sales price of the freehold only.

5. Conclusion

Today we are often confronted with existing split ownership structures in the real estate market as a result of the historical ruling practice of the Ruling Commission.

The tax treatment upon early termination of those structures / reconstitution of the full ownership depends on the specific facts and circumstances. A reconstitution within the same group that performed the historical split acquisition (or at the level of the leasehold / freehold company itself) will in principle result in respectively a 10% or 12,5% transfer tax on the property's full market value. Provided a third party investor is involved, the federal Ruling Commission and VLABEL (under certain reservations) normally (depending on the specific facts) allow the unwinding of existing split structures at respectively 2% on the market value of the leasehold and 10% or12,5% on the market value of the freehold.

Upon exit of a split ownership structure, one should keep these new developments in mind and consider submitting the contemplated reconstitution of the full ownership to the Ruling Commission or VLABEL in order to obtain upfront legal certainty

The Brussels government grants commercial lease loan to tenants

The coronavirus increasingly impacts the day-to-day management of companies. Traders and artisans must comply with their commercial lease obligations which can have a major effect on the liquidity of these companies. On 17 December 2020, the Brussels government came up with an aid measure. With this measure, the Brussels government wants to support traders and artisans who have difficulties in paying the rent of their commercial premises on Brussels' territory and to support the owners of those premises. The Flemish Region has a similar measure.

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The Special Powers Decree of the Brussels government

The Special Powers Decree of 17 December 2020 gives the Brussels Minister of Economy the power to grant a loan to the tenant. As a result of the various corona measures taken by the National Security Council since March 2020, it has become difficult for many tenants to continue paying their rent.

This Decree attempts to respond to this problem. The Brussels government provides an aid measure to the tenant in the form of a loan corresponding to one to maximum four months' rent including charges, which is conditional on a partial waiver of the rent of one to four months including charges by the landlord. As a basis for the commercial lease loan, the tenant must enter into a voluntary agreement with the landlord.

The tenant may borrow a maximum amount of EUR 35,000 over 2 years. This applies to one or more commercial properties together. The repayment of the loan will only start six months after the commercial lease loan has been granted and must be repaid within 18 months at an interest rate of 2% per annum.

Furthermore, for the measure to apply, the rented property must be located in the Brussels Region and the tenant must have been renting the property since at least 18 March 2020 and may not have any rent arrears before that date. Not only tenants that were forced to close (during the first or second lockdown) can take out the commercial lease loan. This is different in the Flemish Region. The Flemish government demands that the commercial premises were effectively closed.

The Council of State states in its advice that garage owners, hairdressers, hotel owners etc. are covered by this measure. The condition of "direct contact with the public" must be met. On the other hand, notaries or lawyers renting an office are not eligible for the measure since they are subject to the ordinary federal rules on rent (*gemene huurrecht* / *le droit commun du bail).*

The tenant must make an application via the website of "Brussel Economie en Werkgelegenheid (BEW)". The application must be received by 30 June 2021 at the latest. Brussel has earmarked EUR 27 million for this aid measure.

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