



BUILT ENVIRONMENT
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Welcome

We are delighted to introduce our third issue of Built Environment Insights, our biannual publication in which we cover key topical issues for the Built Environment industry from around the globe. In this varied edition we explore environmental considerations in real estate transactions, the new boom in Irish construction and the rise of flexible working.

We hope you find this edition of Built Environment Insights useful and enjoy reading this issue. If you have any feedback or if there are any topics you would like us to cover in future editions, please email builtenvironmentinsights@ashurst.com



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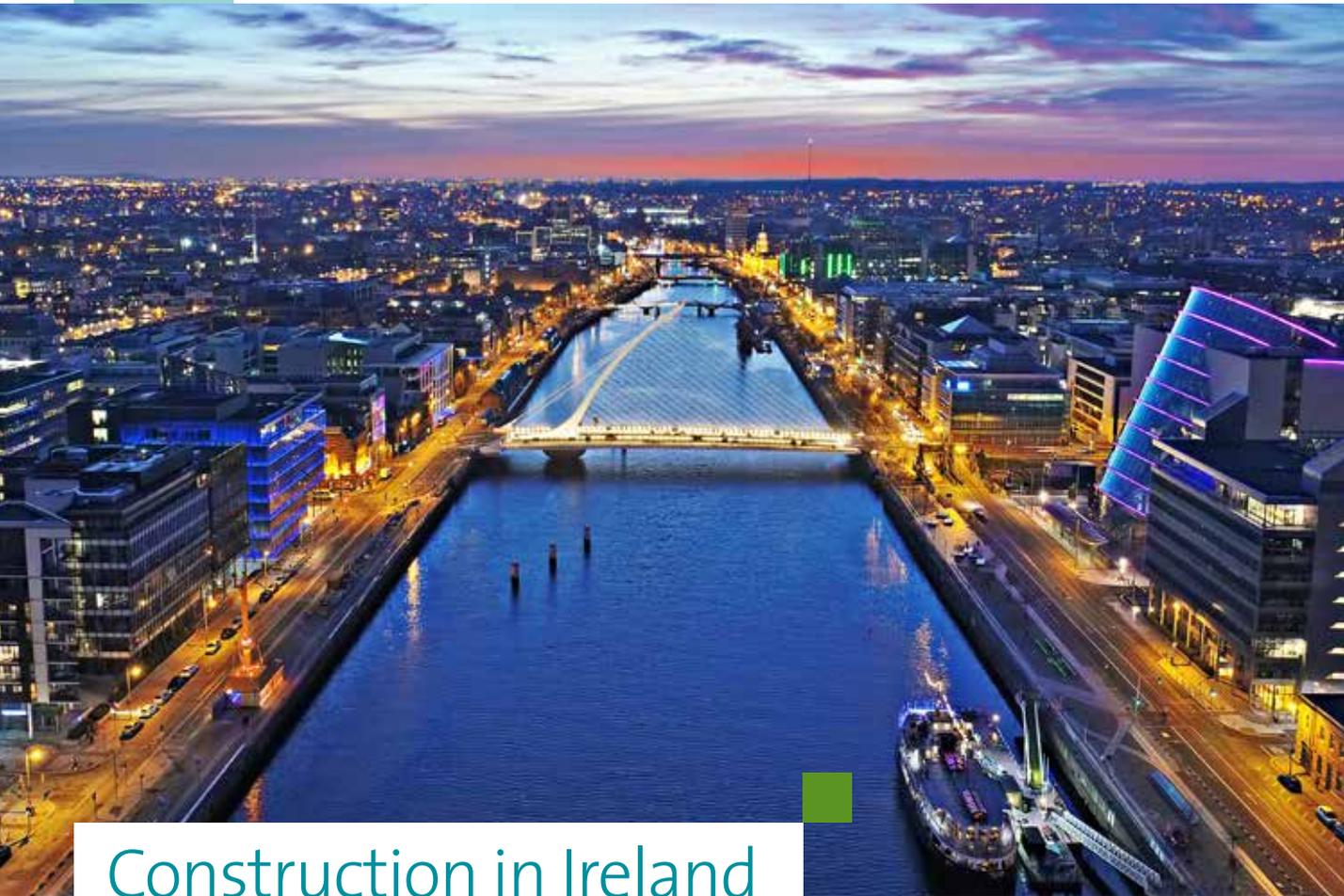


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Construction in Ireland

A new boom?

by Sadia McEvoy

Ten years on from the financial crash, the Irish economy is booming and the construction industry is seeing strong growth. Can the sector stand the pace?

The Celtic Tiger economic boom was driven in part by the country's house building industry. Equally, the financial crisis that followed was a result of the debt that homebuilding and buying engendered. As the financial crisis unfolded, the construction industry collapsed and pictures of unfinished developments became emblematic of Ireland's economic failure.

CHALLENGES OF THE CURRENT MARKET

Whereas at the peak of the boom in the region of 90,000 homes a

year were being built, in 2015 the number was less than 13,000. The consequence, particularly in Dublin, is a chronic housing shortage that poses a problem not only for potential homeowners and renters but is seen by the government as a direct challenge to Ireland's economic future. While its rapid rebound from the crash has seen the Irish economy become one of the fastest growing in the Eurozone, the country's attraction for foreign investment is threatened by the absence of high-quality housing and associated infrastructure,

both economic, such as roads and broadband, and social, such as schools and healthcare.

Without housing for their workforce the attraction of Ireland to overseas companies is compromised but in any event concerns exist regarding the adequacy of supply of office space. While Dublin has already established itself as an attractive outpost of Silicon Valley within Europe, with companies such as Facebook, Google and LinkedIn employing thousands of people, and is an established base for pharmaceutical and service businesses, its ability to meet increasing demand is uncertain. Projects that were started after the recession are only just reaching completion and a lot of old stock is in the process of being demolished

to make way for new buildings. The consequences are very low vacancy rates and limited options for companies looking to set up a base in Dublin.

A NEW BOOM?

Given the shortages in commercial and residential property it is no surprise that Ireland is experiencing a new boom across the construction sector. According to the latest Construction Purchasing Managers' Index from Ulster Bank, housing and commercial activities both showed strong growth in 2017. Construction is set to expand again in 2018, with Aecom Ireland estimating 14% growth.

The strong economy, shortage of housing and the rapid rise of house prices have all conspired to

bring Ireland back to the attention of global institutions, private equity and real estate investment trusts seeking to invest in real estate. Brexit has, of course, also fuelled interest. While Ireland has the largest trade exposure to the UK of any EU country and has the potential to be negatively impacted, there is considerable optimism that Brexit offers a wealth of opportunities for investors who might see London as overpriced and who also want to retain a foothold in the European Union.

PRS

There is also an increasing appetite among investors towards "alternative" sectors such as the Private Rented Sector (PRS) and Purpose-Built Student Accommodation (also known as PBSA). These sectors are seen to have less volatile income characteristics, potential for capital growth and provide diversification. According to Jones Lang LaSalle, PRS in Ireland was of particular interest to investors in 2017 and they expect continued activity in this sector in 2018. Property consultants, Savills, estimate that approximately 18.9% of people currently live in private rented accommodation in Ireland (24.5% in Dublin) and that figure is anticipated to rise. Scarcity of accommodation means that vacancy rates are being driven lower (currently estimated at being in the region of only 1.3%), which, together with strong rents (despite rent controls in certain areas), adds to the attraction of PRS as a stable investment opportunity. The fact that property prices continue to advance faster than earnings means that the rental sector is unlikely to slow down any time soon.



BUILD-TO-RENT

Evidence indicates that it is not just young professionals and students who are renting. Couples, families, migrant workers and pensioners are all represented in the shift. To cater for this increasingly diverse market, the concept of “Build-to-Rent” is gaining traction in Ireland. Build-to-Rent typically involves large-scale development, with on-site staff and amenities, and long-term ownership by a single entity engendering a sense of investment and community in the project. Although a well-established model in some markets, including the United States and Canada, and a growing sector in the UK, in Ireland it is still new. Nevertheless, Build-to-Rent may offer a viable solution to issues of affordability as well as the changing demographic where the greatest need is no longer for the traditional three-bedroomed, semi-detached home, but for smaller housing units.

The Irish government recognises the potential of Build-to-Rent and has invested in its future by prioritising planning applications for such schemes and exempting them from recent legislation to limit potential rental increases in certain areas. Experienced international Built-to-Rent operators, such as Hines and Kennedy Wilson, are also actively engaged in this sector in the Irish market. Since the crash in 2008, Kennedy Wilson has invested substantially in Ireland and their portfolio includes not only retail, commercial and PBSA, but also multi-unit Build-to-Rent schemes such as Clancy Quay – the largest apartment project in the country. Hines is the leading developer at Cherrywood, a 400-acre site in South East Dublin, and has recently agreed a joint venture with Dutch pension investor, APG, to develop 1,300 units.

According to Brian Moran, Senior Managing Director of Hines’ Dublin office, Hines plans to acquire other sites for volume development in the sector as sites are released.

STUDENT ACCOMMODATION

Purpose-Built Student Accommodation (PBSA) is another area of potential growth in Ireland. Like PRS, it is seen by international investors as a safe home for their money. PBSA has been a success story in the last decade in the UK as the shift from student houses – often older properties owned by small landlords – to purpose-built housing in large new blocks with facilities such as gyms, bike stores and cinema rooms, has offered

investment opportunities. Data has shown that since 2007 in the UK, growth in bed-space in private blocks has vastly outstripped that of university-owned halls of residence.

Investors are already capitalising on similar opportunities in Ireland. Hines entered the PBSA market in Dublin around 18 months ago and already has over 1,200 units under management with a further 500 in the pipeline. According to UK-headquartered GSA, Dublin has 80,000 full time students and a further 100,000 coming to the city to study English language each year. These numbers could increase if Brexit results in more European students heading for Ireland rather than the UK.





The potential of this sector is evident from a GSA project in Dublin. In Autumn 2017 GSA launched a 400-room development in Dublin's Liberties area and despite rents rising above €1300 a month, the development is fully booked for the current academic year. GSA have a number of other schemes in the pipeline and plan on looking beyond Dublin to other parts of the country such as Galway in the future. However, the success of PBSA schemes is tied to their location and what works in Dublin may be less successful in other parts of Ireland. Evidence from the UK indicates that the higher the ranking of the university the better the financial outcome of the PBSA scheme.

TECHNICAL INNOVATION

Both PRS and PBSA have the potential to help alleviate the chronic under-supply of housing, particularly

in Dublin. Ireland also has technical capability, for example, in the offsite manufacturing (also known as modular building) sector, which could help solve the housing problem. Certainly, in the UK, the government sees it as a potential solution to its own housing crisis: in November 2017, UK Chancellor, Philip Hammond, acknowledging the importance of modernisation and innovation to the future of the industry, stated that the government will drive adoption of modern methods of construction, such as offsite manufacturing. Historically, poor durability and structural performance contributed to a perception of prefabricated construction as inferior to more traditional methods, but in recent years an incremental approach has seen an increase in the successful use of modular construction, for example, bathroom pods and façade manufacture.

Innovative strategies can alleviate the challenges Ireland faces in other ways too. For example, Aecom, in its Annual Review 2018, draws attention to the potential of brownfield sites and cites the successful development of Dublin Docklands. Agricultural land also offers opportunities. Facebook is expanding with a new data centre in County Meath. The centre is considered to be one of the most energy-efficient in the world being 100 per cent powered by wind energy.

THE FUTURE

It's not only the housing shortage and lack of associated infrastructure that poses a threat to the country's economic model. Rising interest rates, increasing protectionism and a shortage of skilled construction workers are further challenges. The bottom line is that the Irish construction industry is still playing catch up and will be doing so for a number of years. But the will is there, not only domestically but also from international investors. This is seen by many as the key distinction between now and the pre-2008 position. Whereas then the industry was largely debt-funded by Irish developers, the current boom is heavily weighted in favour of institutional money with more equity and less debt. Combined with an increased focus on innovation and receptiveness to changing demographics and lifestyle choices, the outlook for a durable, thriving Irish construction industry seems positive.



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Australian foreign investment landscape

A changing landscape

by Pauline Tan and David Wang

Australia's foreign investment landscape has undergone significant change over the course of 2017. Some of these changes provide greater transparency and flexibility for foreign investors and streamline the Australian foreign investment framework. In this article, we take a look at some of these changes and what they mean for foreign investors.

INCREASED SCRUTINY OF STAPLED STRUCTURES

Ever since their introduction in the late 1980s, stapled structures (investment vehicles in which two or more securities are contractually bound or “stapled” together, such that they cannot be bought or sold separately) have been a common feature of Australia's investment landscape. A typical stapled structure used in Australia involves a passive asset-owning trust (which is taxed on a “flow-through” basis rather than as a company) and a related active operating company,

whose respective units and shares are stapled together.

Despite their common usage as an investment structure, the Australian Tax Office (ATO) announced in January 2017 that it would be targeting certain stapled structures which attempt to artificially re-characterise active trading income into concessional taxed passive income. Following the ATO's announcement, the Treasury announced in March 2017 that the Government would re-examine the effectiveness of the taxation regime as it applies to stapled structures

and consider measures to remove the tax advantages of stapled structures.

Which stapled structures are affected?

In the review of stapled structures, the ATO has made clear that it is not concerned with Australian real estate investment trusts (A-REITs), which derive all or most of their rental income from unrelated third party tenants and certain privatisations of land (or land improvements) based business (although the ATO has indicated that it will continue to engage with privatisations on a case-by-case basis). The passive rental income generated by A-REITs should continue to be taxed on a flow-through basis.

The types of stapled structures which are currently in the ATO's crosshairs include:

- a. rental staples, in which an asset trust holds land or fixtures that are leased to the operating entity to operate its business. The nature of this business may not be divisible in any commercially meaningful way and typically involves transactions which third parties acting at arm's length would not ordinarily enter into; and
- b. synthetic equity staples, in which an asset trust and operating entity enter into an arrangement under which the operating entity pays profit equivalent or turnover equivalent amounts (or amounts which in substance have a similar effect to such payments) to the asset trust.

Investors who implement such arrangements (particularly in sectors such as hotel, aged care and student accommodation) should expect and be prepared for increased scrutiny

from, and engagement with, the ATO. Foreign investors seeking approval from the Foreign Investment Review Board (FIRB) should also expect early engagement with the ATO as it is likely that FIRB will refer such cases to the ATO as part of the approval process.

The future for stapled structures?

The increased scrutiny of the ATO and Government on stapled securities has made clear that changes in Australian income tax legislation that affect existing and contemplated stapled arrangements are on the horizon. Although the consultation process on the stapled structures review ended in September 2017, the recommendations are yet to be released and there has been no clear policy guidance from the Government at this stage on the future treatment of stapled structures. In light of this uncertainty, it will be important for foreign investors to closely monitor the ATO's position on stapled structures and any further developments in this space.

EMERGING ASSET CLASS: BUILD-TO-RENT

Changing social attitudes toward housing and renting (which reveal a growing preference in younger generations for mobile living over home ownership), the affordability of housing in gateway cities and the current focus of Australian planning regimes on encouraging density and maximising existing infrastructure, have all contributed to an increased interest in Australia in build-to-rent (also known as "multi-family" in the US and the "private rental sector" in the UK).

Build-to-rent is an asset class involving the ownership of residential property which is built





to be owned by a single private or institutional investor and held for the medium-to long-term for rental income. Since the release of the 2017-18 budget, in which the Government announced it would be providing tax incentives to increase private and institutional investment in affordable housing, investors have shown interest in investing in the build-to-rent sector in Australia, particularly through the use of managed investment trusts (MITs) which attract a concessional withholding tax rate of 15% on passive income distributions to foreign investors tax resident in “exchange information” countries.

In September 2017, the Treasury released draft legislation aimed at addressing issues of housing affordability by providing incentives for investors to invest in affordable housing in Australia. The draft legislation promotes direct investment in affordable housing; for example, by providing an extra

10% capital gains discount (i.e., a total discount of 60%) for Australian resident individuals investing in affordable housing and by enabling foreign investors investing in affordable housing through MITs to access the concessional 15% withholding rate. However, it also has the effect of disqualifying a trust from having MIT status if it invests in residential property (but not commercial residential premises) other than affordable housing (other than for certain incidental use). The consequence of the draft legislation is that a trust cannot qualify for MIT status if it invests in a build-to-rent asset other than affordable housing (and commercial residential premises). The response from commentators and stakeholders to the draft legislation has been understandably mixed.

Industry bodies and investors are engaged and working with State and Federal governments to consider drivers that will have an

effect on investment in this sector. The outcome of these ongoing discussions will determine whether build-to-rent has the potential of becoming a significant and established asset class in Australia – so watch this space.

CLARITY ON PROPERTY SURCHARGES

Surcharge stamp duty rates apply in New South Wales, Victoria, Queensland and South Australia to foreign persons who purchase residential property. The Western Australian government has also announced its intention to introduce a similar surcharge at the rate of 4% with effect from 1 January 2019. The rate of the surcharge ranges from 3% to 8%, and the definition of foreign persons and residential property differs from State to State. The good news for investors is that these surcharges do not apply to various categories of commercial residential property, which may include hotels,

retirement villages and student accommodation.

New South Wales, Victoria and Queensland also impose a land tax surcharge on foreign absentee owners of land. The rate of the surcharge is 2% in New South Wales and 1.5% in Victoria and Queensland. The definition of a foreign absentee owner differs from State to State. In New South Wales, the surcharge only applies to residential land.

Victoria also imposes a vacant residential land tax of 1% of the capital improved value of taxable land in certain areas of Melbourne for residential land which is left unoccupied for six months or more in a calendar year. If residential property is subject to the vacant residential land tax, notification must be made to the Victorian State Revenue Office via their online portal

by 15 January each year. Exemptions may apply.

An annual vacancy charge is imposed by the Commonwealth Government for vacant residential property held by foreign owners. The annual vacancy charge is equal to the relevant foreign investment application fee paid by the foreign investor for obtaining approval to purchase the residential property and applies to all foreign investors who make a FIRB application (or would be required to do so in the absence of an exemption certificate).

Foreign owners of residential property must now also keep occupancy records for a period of up to five years and report annually to the ATO, by lodging a vacancy fee return in respect of each residential property owned. These obligations apply even if there is no liability to

pay the annual vacancy charge, and failure to submit the vacancy return will result in a deemed vacancy.

There is no liability to pay the annual vacancy charge where a property is occupied or genuinely available on the rental market for at least six months in a 12-month period. Accordingly, the annual vacancy charge should have limited application to institutional investors who are looking to invest in commercial residential assets (such as build-to-rent). The annual vacancy charge will be of greater relevance to foreign developers of residential property seeking to sell rather than rent and should be taken into account at the FIRB approval stage for the development.

STREAMLINING THE AUSTRALIAN FOREIGN INVESTMENT FRAMEWORK

Changes introduced to the Australian foreign investment framework in recent times aim to clarify requirements, reduce regulatory burdens and simplify procedures for foreign investments. Outlined below is a summary of some of the key changes which took effect from 1 July 2017.

New business exemption certificate to cover a programme of acquisitions of interests

A new exemption certificate has been introduced which allows the acquisition of interests in the assets of an Australian business and/or securities in an entity. The exemption certificate allows for a foreign investor to obtain pre-approval for a programme of acquisitions, rather than having to make separate notifications in respect of each proposed action.

The new exemption certificate will likely be useful for foreign investors who are interested in investing in multiple interests over a specified



period of time and should reduce the regulatory burdens and costs involved in making these kinds of applications.

New residential exemption certificate

A new residential exemption certificate has also been introduced by FIRB which allows foreign investors to seek broad pre-approval from FIRB for the purchase of a new dwelling or vacant land out of multiple new dwellings. Given the current development cycle in Australia, which has seen sustained interest in the development of apartments and mixed-use assets with a residential component, this exemption certificate may be of particular assistance to foreign investors looking to invest in residential property.

Property developers and vendors can apply for a new dwelling exemption certificate (NDEC), allowing them to sell new dwellings in a development to foreign purchasers without such purchasers having to obtain their own FIRB approval, provided that the development:

- a. is comprised of one or more multi-storey buildings;
- b. consists of 50 or more dwellings; and
- c. has received development approval and FIRB approval (if required).

As an NDEC relieves foreign purchasers from having to obtain their own FIRB approvals, developments with an NDEC in place are likely to be viewed as more attractive by investors. However, developers should be aware of the restrictions that apply to all applications for NDECs received and approved from 9 May 2017, which prevent developers from selling more than 50% of the total dwellings in the development to foreign persons.





Clarification regarding the treatment of commercial residential land

Prior to 1 July 2017, there was uncertainty regarding whether residential premises that have a commercial use should be treated as residential or commercial land for the purposes of notification under the legislation. With the recent changes to the Australian foreign investment framework, this position has now been clarified. The definition of commercial residential premises has been amended to include residential property types which are commercial in nature, including student accommodation, aged care facilities and retirement villages.

This is good news for foreign investors who are interested in these asset classes, given that acquisitions of an interest in residential premises that have a commercial use are now subject to the higher monetary

thresholds for developed commercial land (being A\$55 million or A\$252 million, depending on the nature of interest in the land being acquired).

Solar and wind farms

From 1 July 2017, land that contains a wind or solar power station will be treated as developed commercial land rather than vacant commercial land where the wind or solar power station is on the surface of the land.

Where the land is yet to be developed as a solar or wind farm, it may be considered to be either agricultural land or developed commercial premises depending on the status of approvals in place for its use as a solar or wind farm.

Reduced red tape for foreign government investors in a consortium

Prior to the amendments, consortia containing foreign government investors were required to make

separate notifications to FIRB for the acquisition of interests in an investment vehicle to fund the subsequent acquisition of an asset (which is notifiable) through the investment vehicle (even where the funding by investors is for the acquisition).

In order to streamline the notification process and reduce costs and red tape for foreign government investors, FIRB has confirmed that the acquisition of a direct interest in a consortium vehicle to effect a notifiable acquisition does not separately need to be notified.



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Turning green thinking into green growth factors

Environmental, Social and Governance (ESG)

by Eleanor Reeves and Joanna Fox

Investors and business leaders are not only recognising the importance of Environmental, Social and Governance (ESG) factors in the assessment of long-term growth and risk, but are now taking action to protect their interests.

In this article, we explore why ESG factors are particularly relevant to the Built Environment sector, and how early identification of ESG factors and appropriate risk management can convert green thinking into opportunity.

WHAT IS “ESG”?

ESG factors are a broad and flexible collection of risks, including:

- Environmental: climate change, environmental damage, resource depletion

- Social: slavery, indigenous communities, diversity, health and safety
- Governance: executive pay, bribery and corruption, diversity of boards, tax

Individual ESG factors regularly make the news headlines. An article in the Financial Times pointed out that the increase in the disclosure of ESG-related data has made it easier to assess the financial impact of ESG risks, and has facilitated the incorporation of these risks into investment models.¹ The

article refers to a study by Boston Consulting Group which showed that companies with more ethical operations make larger profits.² The increase in ESG-related information can be directly linked to investor interest and action through share prices, and individual events have greater potential to affect an entire industry.³

ESG factors are also increasingly interconnected with other global risks. The World Economic Forum's 2018 Global Risks Report⁴ highlights not only the growing prominence of environmental risks, but also the systemic challenge of the increasing interconnectedness of environmental and other global risk factors, including disruption to critical infrastructure.

WHY IS ESG PARTICULARLY RELEVANT TO THE BUILT ENVIRONMENT SECTOR?

There are a number of indicators that expectations are changing in the Built Environment sector, including the development and uptake of disclosure tools and guidance. In 2017, 850 property companies and funds participated in the Global Real Estate Sustainability Benchmark (GRESB) Real Estate

Assessment, suggesting that ESG disclosure is becoming market standard in the Built Environment sector.⁵ The GRESB Assessment is a key tool for providing information to investors. Information is collected through GRESB Assessments, which are completed by the company by providing ESG data, which GRESB then validates, scores and benchmarks.⁶ New RICS professional standards and guidance will also come into effect from May 2018 and will focus on the whole carbon life cycle, including the construction and use of real estate.⁷ This will feed into broader assessments such as the BREEAM sustainability assessment for buildings. Public interest has also played a part in driving ESG in the Built Environment sector. For example, the WELL Building Standard can be attributed at least in part to public demand and people's desire to live and work in environmentally friendly buildings that promote health and wellbeing.

More broadly, investors are concerned about a range of ESG-related issues. For example, if a portfolio company fails to take into account ESG factors in its business strategy, it may no longer be in a position to meet

its financial objectives, or may fail to retain its best employees who are attracted to more innovative working environments or business models. Investors may also fear the consequences of reputational damage if public opinion about a portfolio company's supply chain or wider business activities turns negative, or if the company has failed to put in place preventative measures to safeguard against foreseeable ESG risks.

ESG REPORTING AND DUE DILIGENCE

Investors are a key driving force behind the increased focus on ESG. The six Principles for Responsible Investment are a set of voluntary and aspirational principles for investors, launched in April 2006, which now have more than 1,800 signatories from over 50 countries representing approximately US\$70 trillion of assets⁸ according to the PRI website. The six Principles include commitments to incorporate ESG issues into investment analysis and decision-making processes, and report on activities and progress towards implementing the Principles.

The Equator Principles, originally launched in June 2003, also act as a guide for financial institutions to determine, assess and manage the environmental and social impact of projects, in particular during the due diligence process. Project companies need to demonstrate to lenders that they are identifying ESG-related risks and taking mitigating action to ensure that their approach to ESG can withstand the scrutiny of increasingly well-informed and demanding investors.

There are also mandatory reporting requirements for ESG, including the UK Corporate

FOOTNOTES

1. <https://www.ft.com/content/80c833ce-b994-11e7-8c12-5661783e5589>
2. <https://www.ft.com/content/80c833ce-b994-11e7-8c12-5661783e5589>
3. <https://www2.deloitte.com/insights/us/en/deloitte-review/issue-12/finding-the-value-in-environmental-social-and-governance-performance.html>
4. http://www3.weforum.org/docs/WEF_GRR18_Report.pdf
5. <https://gresb.com/about/>
6. <https://gresb.com/about/>
7. http://www.rics.org/Global/Whole_life_carbon_assessment_for_the_BE_PGguidance_2017.pdf
8. <https://www.unpri.org/about>
9. <https://www.pwc.com/us/en/governance-insights-center/publications/assets/investors-corporate-sand-esg-bridging-the-gap.pdf>
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13. <https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-TCFD-Report-062817.pdf>
14. <https://www.ukgbc.org/wp-content/uploads/2018/01/Capturing-the-Value-of-Sustainability.pdf>
15. <https://www.ukgbc.org/wp-content/uploads/2018/01/Capturing-the-Value-of-Sustainability.pdf>

Governance Code, the EU Non-Financial Reporting Directive and the UK Companies Act 2006. The EU Non-Financial Reporting Directive requires large companies (companies with over 500 employees and whose activities are of significant interest to the public) to produce reports on the social and environmental impacts of their business, including its operations and how the company manages social and environmental challenges. The Companies Act 2006 requires companies who have a duty to prepare a strategic report to include environmental matters where these affect the development, performance or position of the company; and also requires quoted companies to report on greenhouse gas emissions in their directors' reports.

GREEN ENOUGH?

Analysis of gaps in mandatory reporting undertaken to date suggest that ESG risks could be more thoroughly assessed and acted upon by companies. PwC found that only 21 per cent of investors surveyed were "somewhat satisfied" and 72 per cent were "neutral" or "somewhat dissatisfied" with the ESG reporting of portfolio companies.⁹ This is also reflected in an HSBC survey which showed that two-thirds of institutional investors consider that they lack the right information to increase their climate-friendly investments, and would like to do so.¹⁰ In a move to mitigate some of these problems, the UK Government has acknowledged that streamlining energy and carbon reporting would be beneficial, and has proposed the introduction of a simplified reporting framework by April 2019.

On the horizon, further significant developments to ESG reporting include:

- The European Commission is currently considering whether material ESG factors and long-term sustainability should be explicitly integrated into the fiduciary duties of institutional investors and asset managers.¹¹
- The Law Commission's report, "Fiduciary Duties of Investment Intermediaries", recommends that trustees should consider sustainability and ESG factors to the extent that they represent a risk to investment.¹²
- The G20's Task Force on Climate-related Financial Disclosures report, published in June 2017, sets out the task force's recommendations for helping businesses to disclose climate-related financial information for the purposes of enabling this information to

be considered in business and investment decisions, and to demonstrate that a company is considering climate issues.¹³

TURNING GREEN THINKING INTO GREEN GROWTH

Making decisions in line with ESG factors can be financially advantageous. For example, reducing waste and improving energy efficiency can lead to long-term savings, and exercising good corporate governance can help to avoid the consequences of reputational damage. A UK Green Building Council member poll identified the eleven most common value drivers for businesses in the Built Environment industry. At the top of this list were cost savings, talent attraction and





retention, and customer attraction and satisfaction.¹⁴

The UK Green Building Council has also set out six steps that companies can take to maximise the impact of ESG activities:¹⁵

1. Ascertain scope of sustainable business activities: undertake a materiality assessment to identify key sustainability issues and sustainability activities. ESG screening tools can also be used at this stage to identify future opportunities as well as risks for the business.
2. Identify key value drivers: identify the most important drivers of value for the business.
3. Develop performance indicators: based on sustainable activities, value drivers and how the information will be used. Stakeholder engagement will be helpful in this process as it enables companies to identify the information that stakeholders deem important.

4. Metrics of measurement: decide how the data will be analysed and used. These decisions will reflect the chosen performance indicators and the requirements of the company's stakeholders.
5. Method of data collection and reporting: data needs to be consistent to enable comparison over time. Due to the importance that investors are placing on ESG information, companies may consider having their data certified or audited.
6. How the data will be acted upon: decide how, when and by whom the data will be used. This is an integral step in implementing ESG initiatives. Where data has been collected digitally, companies will have options as to how this information is both used by the company and presented to stakeholders.

By refining its approach to ESG and producing clear and consistent reporting, the Built Environment

sector should be better placed to attract investor and public confidence, identify and manage key risk factors, and deliver sustained financial performance.

ESG is undoubtedly becoming an increasingly important consideration for the global investment community in safeguarding long-term financial performance. To keep up with this movement, companies need to place ESG factors at the core of their business strategies and budgets, and ensure that ESG risk management can be effectively implemented.



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Minimum Energy Efficiency Standard

A quick guide

by Alison Murrin

Those who let, invest or finance commercial property need to ask themselves a number of questions as we approach 1 April 2018 when the Minimum Energy Efficiency Standard (MEES) will finally come into force. In this article we will highlight some of the key issues to consider.

WHAT MUST BE DONE TO COMPLY WITH THE MEES REGULATIONS?

Essentially the regulations prescribe that from 1 April 2018 it will be unlawful to grant a lease of commercial premises if the Energy Performance Certificate (EPC) rating falls below an “E”. There are a number of exemptions which may apply which we outline later in the article.

The regulations have a sting in their tail because once we reach 1 April 2023 it will be unlawful to continue to let sub-standard

commercial premises. So, leases of sub-standard premises which were lawfully granted before 1 April 2018 will also be caught.

We are only covering commercial premises here but it is worth pointing out that the regulations also apply to residential premises (with some differences).

WHAT ARE THE EXEMPTIONS?

Before we look at the exemptions let's look at the situations where the MEES Regulations will not apply at all:

- Buildings which are not required to have an EPC (for example: certain listed buildings, places of worship, or temporary buildings).
- Buildings which do not have a valid EPC. An EPC is valid if it is less than 10 years old and it has not been superseded by a more recent EPC.
- Where the tenancy is granted for 99 years or more or is granted for 6 months or less (provided that there is no provision to extend or renew the term and the tenant has not already been in occupation for over 12 months).
- Only tenancies are caught, so licences and tenancies at will are excluded (despite its name a tenancy at will is not a tenancy because it does not have a fixed term).

If the MEES regulations do apply then it is possible to claim an exemption which will enable a lease of sub-standard premises to be lawfully granted. The following exemptions are valid for 5 years and must be registered on the public PRS

Exemptions Register:

- There are no energy efficiency improvements that can be made which will pay for themselves through energy bill savings over a 7-year period.
- The improvements will have a negative impact on the fabric or structure of the building.
- The landlord cannot obtain the necessary third party consents to carry out the improvements (for example, consent from the planning authority, the tenant or mortgagee) despite using reasonable efforts or the consent is subject to unreasonable conditions.
- The works would result in a reduction of more than 5% in the market value of the property.

It should also be noted that these exemptions cannot be assigned to successors in title. So, on the sale of the building the new owner would have to register its own exemption.

There is also a temporary exemption available where the landlord is “forced” into a letting.

The letting prohibition is postponed for 6 months where:

- the landlord is under a contractual obligation to grant the lease. This is very wide and appears to cover leases granted under agreement for lease and other contractual arrangements such as options to renew;
- a lease is granted by operation of law (e.g. because of a deemed surrender and re-grant);
- an overriding lease is granted pursuant to the Landlord and Tenant (Covenants) Act 1995;
- a lease renewal is granted pursuant the Landlord and Tenant Act 1954; and
- a lease is ordered by the court.

A six-month postponement of the letting prohibition will also apply where an entity becomes a landlord because it purchases an interest in a property and there is a tenancy already in place. This exemption is relevant only to the “continue to let” prohibition which kicks in in 2023.

CAN THE EPC RATING BE IMPROVED?

As will be self-evident the EPC rating is now much more important than it has been in the past and having an accurate EPC will be vital. EPCs are valid for 10 years, so if the building has an EPC which was commissioned a number of years ago it may be worth checking the methodology used to produce it. Sometimes it will be possible to increase the EPC rating by simply using more accurate information when doing the EPC calculations.

The alternative would be to consider carrying out the relevant energy efficiency improvement works to the building. However, it may not be possible to carry out these works while the building is let and the works may have to be programmed to coincide with lease expiry dates. You may think that an



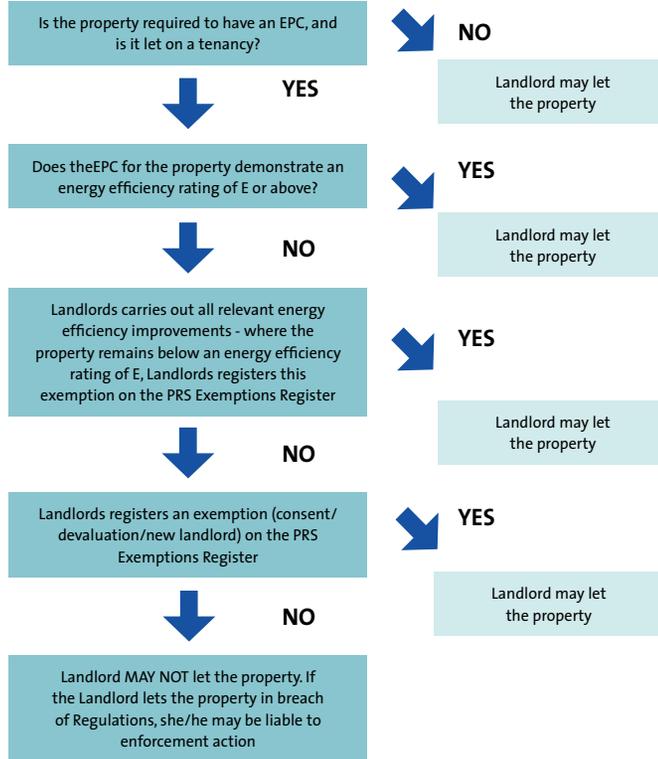
easy solution to this would be to include landlord rights to entry to carry out such works in leases going forward. However this may not be advisable if a landlord wants to take advantage of the “lack of consent” exemption explained above.

A key consideration for a landlord (and indeed an investment purchaser or lender) will be to assess the consequences of not carrying out the works now and, should the works have to be carried out at some point, how much will they cost and who will pay for them.

WHO PAYS FOR THE RELEVANT ENERGY EFFICIENCY IMPROVEMENT WORKS?

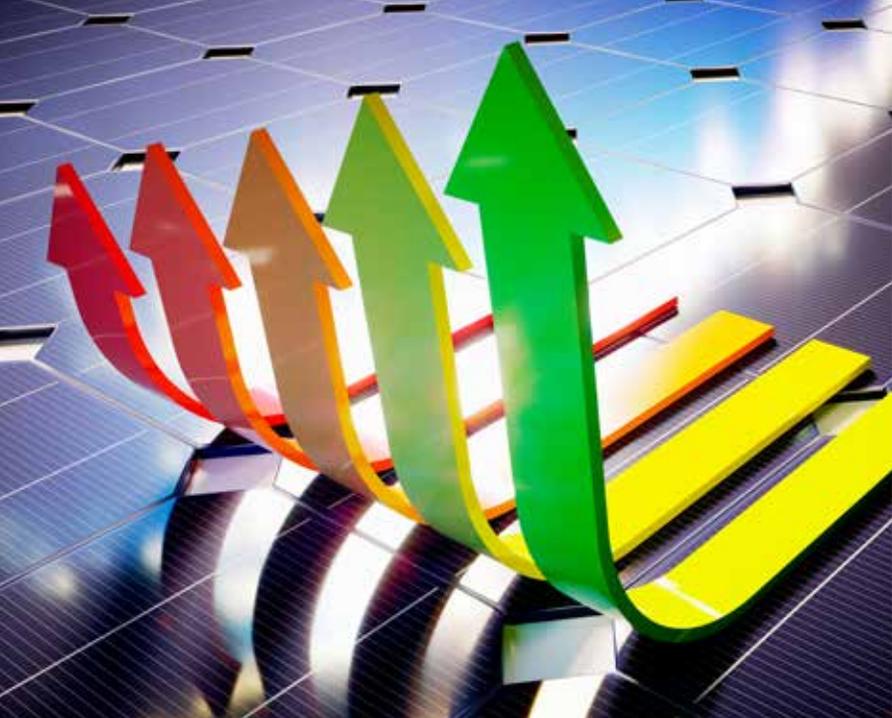
The MEES regulations simply prohibit letting in certain circumstances. They do not impose an obligation to carry out any relevant energy efficiency works. Therefore a landlord who is hoping to pass on the costs to the tenant

Can the landlord let the premises after 1 April 2018 ?



Flowchart from BEIS guidance for non-domestic property February 2017





cannot simply rely on the standard tenant covenant in the lease to comply with all legislation. The lease may need to include specific drafting to require the tenant to pay the costs. This would flag the issue to the tenant who would be unlikely to agree to pay for the improvements, particularly if the tenant only has a short term lease. In such a case there may not be sufficient time for them to see any benefit from the improvements in terms of lower energy bills.

DO LEASES NEED TO ADDRESS MEES?

A landlord will require greater control over the production of EPCs by tenants for the purposes of assignment and sub-letting. This is because the landlord will undoubtedly be able to produce a more accurate EPC as it has access to all the relevant data and will therefore have a better chance of preserving its current EPC rating. A landlord cannot prevent a tenant from obtaining an EPC where it is statutorily obliged to do so, but it can require the tenant to use an

existing EPC or give the landlord the option of commissioning the EPC itself.

Furthermore, a landlord will want to include a covenant preventing the tenant from carrying out any alterations which would adversely affect the EPC rating for the building. Although, absent such wording, there is a strong argument that it will be reasonable for a landlord to refuse consent to alterations that would lead to a sub-standard EPC rating.

The landlord may wish to seek to recover expenditure of relevant energy efficiency improvements through the service charge provisions in the lease. However, a well advised tenant will normally have negotiated a service charge exclusion for the cost of improvements. So the tenant would have to expressly agree to pay for the energy efficiency improvements and most tenants would strike out any such lease provision requiring it to pay these costs.

Rent review clauses should include an assumption that the premises can be lawfully let. This will avoid

the tenant being able to argue that the market rent is zero because the grant of the hypothetical lease is unlawful if the EPC rating for the premises is below an E.

However, as with any new lease drafting it is important to guard against including provisions which might be considered onerous as this could have a detrimental effect on rent review.

WHAT ARE THE PENALTIES FOR NON-COMPLIANCE?

The Local Weights and Measures Authorities will enforce the MEES Regulations. The level of penalty depends upon the duration of the breach and the rateable value of the property, subject to a maximum penalty of £150,000.

In addition the enforcement authority can “name and shame” by publishing details of any breach and penalties imposed (known as “the publication penalty”). However, helpfully, the regulations make it absolutely clear that any tenancy granted in breach of the letting prohibition remains valid and enforceable.

WILL THE GOALPOSTS BE MOVED IN THE FUTURE?

Obviously MEES is driven by EU law and so it remains to be seen whether the regulations will survive Brexit. However, there are signs that they will not disappear following the recent publication of the Government’s Clean Growth Strategy which identifies energy efficiency as a priority and suggests that MEES will be raised to an EPC rating of “C” in the not too distant future.



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Contaminated industrial sites

How to structure a perpetual motion machine

by Hendrik Theismann

Contaminated industrial sites: How to structure a perpetual motion machine that limits the eternal environmental liability for heavy industry sites – or how to turn a liability into an asset

ETERNAL ENVIRONMENTAL LIABILITY

A statistic from the German Ministry of the Environment states that approximately 283,230 properties in Germany are either contaminated or at least suspected to be potentially contaminated.¹ This is partly as a result of two World Wars but also as a result of Germany's strong heavy industry sector, which mirrors the success of Germany's economy. Many of these sites are large former industrial sites that have seen decades of industrial fabrication but for some reason production on

the site has ceased. There are many sites still owned by companies, or their legal successors, which have caused contamination in the past. Having such a property on a company's books means effectively a liability that drags on for years and years necessitating costly safety and decontamination

FOOTNOTES

1. Nationwide overview about contaminated site by the ministry of environment, 9 August 2017, can be found at https://www.umweltbundesamt.de/sites/default/files/medien/378/publikationen/bodenzustand_in_deutschland_o.pdf

measures. In addition, as there are limited incentives to decontaminate where the contamination is permanent or requires long-term treatment, decision makers may opt only for safety measures if the environmental authority does not require more.

The most important environmental legislation in relation to handling contaminated sites is the German Federal Soil Protection Act (FSPA), which came into effect in 1999. The FSPA intends to protect and if necessary restore the functions of the soil on a permanent sustainable basis and to establish the liability of polluters and owners of contaminated sites. As a general rule, the FSPA constitutes the obligation to act in a manner that prevents harmful soil changes and it constitutes what is called “eternal liability”: the owner of a contaminated property is not only under the obligation to remediate the site but also to carry out protection and restriction measures in order to prevent any hazards, considerable disadvantage or nuisance by individuals or the general public. This liability is established simply

by ownership of a site and does not require that the owner has actually caused the pollution. Moreover, the authorities may hold the owner of a contaminated site (the Owner) liable for any costs in connection with measures carried out by the authorities as well as for compensation for damages. The same generally applies to the individual or organisation that has caused the contamination (the Polluter) and the Owner may reclaim costs and compensation provided the Polluter has sufficient financial strength and still exists.

However, if the Owner is also the Polluter – which is the case for many former industrial sites in Germany, they cannot benefit from this provision. To make matters worse, under FSPA, even a former owner of a contaminated property can be held liable if the contamination was already on the site at the time the former owner was the registered owner of the property. It is at the discretion of authorities who they may hold liable – the Owner, the former owner or the Polluter. The authorities only have to take into account who is able to most effectively achieve

the purpose of the intended order (in other words: who can carry out the decontamination measures and who can bear the costs). A sale of a contaminated property may therefore not have an impact in terms of eternal liability either for the Owner/Polluter (who usually has to account for a deferred liability) or for the buyer of a contaminated property (who may also be held liable). The eternal liability under public law is statutory law that cannot be excluded, even if the parties to a sale and purchase agreement agree on a different regime (which would only apply *inter partes*).

From an economic point of view, being the Owner of such a property therefore causes a continuing financial loss. And the “eternal liability” is a barrier that sometimes effectively hinders economically reasonable solutions.

But there is hope: there are strategies to effectively create a perpetual motion machine that functions on a stand-alone basis, with limited input from the Owner’s side, once it is set up and running. While such a machine cannot limit the statutory “eternal liability” in



legal terms, it can factually bring it to an end once it is in motion. This machine may at best generate a profit and can at least remove a liability from the balance sheet.

HOW TO STRUCTURE A PERPETUAL MOTION MACHINE

The starting point is to determine the objectives of the Owner. They may want to sell the contaminated property to a new owner (in the best case scenario with profits) and (to the extent possible) pass over the responsibility for continuous measures (e.g. monitoring obligations) which will cause the eternal liability to end. The Owner would want to minimise the insolvency risks of the buyer of the site (the Investor) because an insolvency might trigger a “boomerang effect”, returning the liability to the Owner.

The easiest way to limit future liability is to introduce a clause in a property sale and purchase agreement that excludes any claims resulting from environmental issues

and obligates the buyer to take care of these and bear any associated costs. This should go hand in hand with a succession clause secured by an easement that should be registered in the land register. This is the way some of the major German (public) infrastructure companies manage their risks, including Deutsche Bahn AG, various airports and harbours. The downside is that this concept has a negative impact on the price and there is no protection in case of an insolvency of the Investor (because then the authority will hold the former Owner liable, again). As a result, this works best if the pollution is not of a material nature and might be completely remedied. But what if the contamination requires steady controls and/or may not be able to be entirely removed (e.g. ground water pollution)?

The first thing to note is that there is no “one-size-fits-all” approach. Each contaminated site is different and requires a particular treatment, some authorities might be stricter

than others and each Owner has different needs. Having said that, there are some components that each machine requires to function:

- the contaminated site should be of a certain size to justify the efforts;
- the site should be suitable for its different use once it has been cleaned (e.g. business park, commercial use, infrastructure projects, etc.);
- decontamination and development of the site might require a reliable developer/ construction company that is able to carry out a project of a certain size;
- the structure is usually complex and therefore requires sophisticated partners on all sides; and
- co-operation of the environmental authority.

A recent project we handled showed that one structure in particular effectively achieves the objectives of most clients. This structure is based on the creation of a heritable building right (Erbbaurecht, “HBR”). To understand this concept better, we have to delve into the German Law of Heritable Building Rights: an HBR is a right in rem similar to a freehold title (grundstücksgleiches Recht) and similar to a long-term lease (e.g. 100 years or more). The owner of an HBR benefits from a limited environmental liability: after the HBR is transferred to a third party, the previous owner of the HBR is no longer liable for his former asset; in other words: there is no eternal liability. This is clearly an incentive for marketing the parcels to Investors.

The first step would then be to transfer title of the contaminated site to a special purpose vehicle with limited liability (SPV) whose sole shareholders are initially the Owner and a developer who shall ultimately





be responsible for decontamination and development of the site. The backbone of this structure is then to split the site into smaller parcels be developed for the Investors after decontamination. However, these smaller parcels shall not be transferred to the end users by way of transfer of title, but by creating a heritable building right (Erbbaurecht, “HBR”) for each parcel.

Each HBR is ready to be sold to the Investors after decontamination. Together with acquisition of an HBR, each end user shall be obliged to acquire shares in an SPV (thereby reducing the shares of the developer and Owner). A control stock, however, will remain with the Owner. This helps the Owner ensure that the structure will not be dissolved at a later stage.

After development of the site and once the HBRs of the parcels are sold to the Investors, the purpose of the SPV shall be to undertake and observe all continuous environmental measures. The SPV will be financed by a rent which

each end user pays for the HBR. All Investors therefore contribute to the costs of ongoing environmental obligations; any profits of the SPV will be distributed to its shareholders, i.e. the Investors. To protect the Owner in the case of insolvency of an Investor, the shares of each Investor should be subject to forfeiture in case of insolvency and the HBR should fall back to SPV (who can then sell the HBR to another Investor) – this can be managed by introducing respective clauses in the relevant agreements.

If we compare the Owner’s objectives with the construction manual for the machine outlined above, we can tick off most boxes: the contaminated site is decontaminated by the developer. The parcels of the site are sold to the Investors in the form of HBRs and the purchase price may make up for the costs for decontamination and at best create a profit. The SPV will take care of any continuous environmental measures whose costs are borne by the Investors and not the Owner.

And, in case of an insolvency of an Investor, the shares in the SPV and the respective HBR can be reclaimed and then sold again.

WRAP-UP

Eternal liability for environmental matters is not the end of the story. Former industrial sites can be turned from a liability into an asset and the eternal liability can be limited. The key factor is to structure projects in a way that meets the demands of the real estate market for the benefit of all parties involved. However, there is more than one road to Rome and we all know this city was not built in a day. Diligent preparation of the contracts that will run the perpetual motion machine for a long period of time is crucial, as well as carefully hand-picking your developer and partners.



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Reinventing the workplace

The evolution of co-working

by Anisha D'Cruz

Industry experts forecast that demand for co-working spaces will continue to grow at an average of 10-15 per cent per annum and that, by 2030, 30 per cent of office space will be in co-working format. In this article we examine the global rise in the popularity of co-working.

The concept of flexible working is not a new one. Providers of serviced and managed offices have provided private offices leased or licensed to occupiers on flexible terms for decades. However, the growth in the popularity of “co-working” as a type of flexible working has been dramatic. Over the past decade the global co-working market has been growing at an average of 13 per cent per annum (a tripling in size since 2006)³ with many providers reporting close to 100 per cent occupancy levels. Overall, close to

three million square feet of central London office stock³ was let to flexible office providers from 2014 to 2016 and a million square feet by the end of June 2017.⁴ As further indication of the buoyancy of the market, the US private equity firm Blackstone acquired the Office Group in June 2017 and in August 2017 Japan’s Softbank invested US\$4.4 billion into WeWork - one of the largest single investments in a private company on record.

While London currently represents the largest co-working market in the

world, flexible office space providers are continuing to expand their offering in major global cities. Many SMEs are now opting for co-working spaces over traditional leasing options and even large established companies are increasingly favouring co-working spaces. In this article we explore why the sector is flourishing and where it is heading.

THE ECONOMIC AND POLITICAL LANDSCAPE

The aftermath of the global recession saw a 22 per cent growth in small and micro businesses⁵ and the emergence of the co-working trend in the flexible office market. SMEs make up the majority of flexible office providers' customer base, and the appeal of co-working reaches beyond the cost savings

it offers. Growing SMEs are able to triple their workforce within a matter of months and it is vital that the property they occupy has the capacity to evolve and adapt as the business does. Co-working overcomes many of the challenges of traditional fixed term office leases faced by SMEs, by allowing them to take space as and when they need it and expand, upgrade and

THE GLOBAL HOTSPOTS¹

London and New York currently represent the largest markets for flexible workspace, followed by EMEA (excluding the UK) and APAC.



- 1. London** – WeWork's lease of 280,000 square feet at Two Southbank Place was recorded as one of the largest leasing deals of 2017
- 2. New York, Los Angeles, San Francisco and Chicago** – an average of 37% of space is now described as co-working in these US cities combined
- 3. Abu Dhabi**
- 4. Berlin** – Berlin has the largest proportion (70%) of co-working centres out of 123 sites
- 5. Paris** – Hosts the world's biggest start-up campus, "Station F"
- 6. Dublin** – Current providers have announced expansion plans and new providers are entering the market in 2018
- 7. Shanghai**
- 8. Hong Kong** – The Hong Kong market grew by 16% in 2016 and has approximately doubled in size since 2014
- 9. Melbourne and Sydney** – 9% and 7% growth in 2016 respectively
- 10. Singapore** – 22% growth in 2016



downgrade at short notice. Many co-working spaces also allow for the cost-effective customisation of workspaces, enabling SMEs to avoid significant financial outlay in modifying buildings to accommodate their rapidly changing requirements.

Although the co-working movement has its origins among freelancers, entrepreneurs and the tech industry, it is increasingly relevant for a broader range of organisations. Large corporations have used flexible office space for some time to set up project teams, or in some cases to provide an efficient and cost-effective solution prior to expansion into a new market. However, since the global financial crisis, corporations have been more reluctant to sign up to long leases and are frequently negotiating break clauses in office leases.

Looking at the current political landscape, the lack of any conclusive agreements between the UK and EU to date has meant that the effect of Brexit on the European office market has been limited, however, the recent Citibase Confidence Index revealed that only 33 per cent of SMEs are confident that the UK Government will secure a good deal for the UK, and a number of banks have put contingency plans in place to hedge the risks of Brexit and redistribute their core operations to Europe (Frankfurt being a popular preferred location). While the current uncertainty prevails, the flexibility afforded by co-working is likely to remain a key consideration for real estate decision makers, particularly those within the finance sector, over the security afforded by traditional long-term leases.

WHAT IS CO-WORKING?

- The use of a working environment by a diverse group of professionals seeking to access and share equipment, ideas and knowledge.
- The format is typically a combination of private offices with open-plan areas where users can work and interact.
- Co-working schemes run on a membership basis and desks can be hired daily, monthly or for longer periods of time.
- Unlike traditional flexible working schemes, the value of the activities taking place within the physical space are as important as the physical space itself. The defining feature of co working is the experience and quality of the interactions offered by the environment.
- In addition to desk space, membership fees provide access to a range of amenities, including meeting rooms, Wi-Fi, refreshments, weekly seminars and shared staff (such as receptionists).

RISING RENTS

Rents are continuing to increase in most office markets, with prime European office rents forecast to rise by 4.9 per cent in 2018. While rents for long term office leases have risen steadily, membership fees for co-working spaces have risen at a slower pace. According to research by workspace innovation company The Instant Group, the cost of a flexible workstation in London is £8,800 a year, being 47 per cent cheaper than a traditional workspace. In Hong Kong, a flexible workspace is 72 per cent cheaper than a conventional desk (recorded as the most expensive workspace in the world at US\$27,432 a year). Cities such as Tokyo and Sydney emulate this, offering users a cost saving of more than 40 per cent. While the difference is less dramatic in New York, co-working still provides a 16 per cent cost saving.⁶ Industry experts expect co-working membership fees in the London market to stay comparatively low in 2018, with supply continuing to grow as existing providers expand and new providers enter the market.

LOCATION

By providing users with access to desk space in key central business locations, co-working also unlocks office stock previously inaccessible to SMEs, due to their inability to provide the funds or covenant strength typically required by landlords of prime real estate assets. The ability to operate in close proximity to key business connections is highly valuable to growing businesses, and the worldwide availability of co-working spaces removes many of the barriers to overseas expansion.

While the ability to operate from a central business location may appeal

to some established corporations seeking additional desk space on flexible terms, the main attraction of establishing a presence in a co-working environment is access to talent and SMEs at an early stage in their business life, at a low cost and in a low risk environment. A number of companies with 1,000 or more global employees (including General Electric, MasterCard and Samsung⁷) are among flexible workspace provider WeWork's occupiers.

TECHNOLOGY

Technology has been a major driving force behind the co-working trend. As technology continues to transform the way we work, people are becoming less reliant on a fixed base in a traditional office environment.

Flexible workspace providers have responded to the increasing demand for the real estate market to become more "service-orientated" by listing, and allowing users to search, book and pay for, desk space via online platforms, significantly reducing the time and cost of locating office space.

Within the workspace, technology with the primary purpose of simplifying work tasks (e.g. 3D printing and printing via the cloud rather than physical connection to a printer) and that which allows the user to merge work and personal life (e.g. dry-cleaning and catering services) are employed to draw in occupiers. Cloud technology and mobile solutions are also removing geographical boundaries by enabling agile global collaboration between professionals.

ACCOUNTING CHANGES

The International Accounting Standards Board and the US Financial Accounting Standards Board announced lease accounting changes in 2016. Under the current rules, long-term lease obligations are not reflected on companies' balance sheets, and consequently the financial impact is not visible to stakeholders. The revised standards, which will come into effect in 2019, require long-term property leases to appear on balance sheets. Short-term leases of under 12 months,



however, will be exempt from the new standards. This may contribute to continuing demand for co-working spaces from corporations.

WHAT DOES THIS MEAN FOR LANDLORDS?

Flexible working bolstered London's leasing market in 2017, accounting for 18 per cent of all office space in central London in the first half of 2017.⁸ WeWork's lease of 280,000 square feet at Two Southbank Place SE1 was recorded as one of the largest leasing deals of the year, and office space usually reserved for large corporate companies (for example London's 120 Moorgate and One Poultry, and New York's iconic Lord & Taylor department store) were among the headline real estate deals of 2017.

In addition to lettings of prime central business district office space to flexible workspace providers, landlords are responding to this trend by seeking to incorporate flexible space elements in new developments from inception, along with wellness facilities and other shared amenities, and are increasingly receptive to the mutual benefits of reinvesting in older spaces to create appealing work environments which draw in a diverse range of occupiers. "Traditional" real estate companies are also joining the co-working sector; for example, in the UK, British Land launched Storey in 2017, which provides workspace to small and large businesses on flexible terms.

The trend is not confined to the traditional office market. Landlords of non-office buildings are entering the sector to enable the efficient use of under-used space, with the ability to claw back space if needed. By harnessing a wider range of social interaction, landlords are able both to cut out intermediaries from the

income stream and drive footfall to their assets. For example, in London, Heal's department store and private members clubs the Zetter Townhouse and the Curtain all offer co-working facilities. In New York, the Public Restaurant operates co-working hubs before the restaurant opens for business. Many companies are also bringing the benefits of co-working into their offices, enabling the economic use of space, facilitating access to talent and in turn providing SMEs with access to expertise to take their business forward. For example:

- Google Campus: A global network of spaces operated by "Google for Entrepreneurs" to assist start-ups.
- Westfield: The fourth floor of the San Francisco mall is home to "Bespoke", a hub for online retail start-ups.

- Barclays: the bank operates 13 "Eagle Labs" in under-utilised branch and office spaces in the UK to provide entrepreneurs with mentoring and advice.
- National Australia Bank: "The Village Innovation Centre" in Melbourne seeks to facilitate community, connection and collaboration.

WHAT DOES THIS MEAN FOR TRADITIONAL OFFICE-SPACE PROVIDERS?

Is traditional office space disappearing?

Far from it. Although the rate of growth has been dramatic, flexible workspace in the largest market, London, only accounts for 4 per cent of all London office space.⁹ While the cost savings and networking opportunities co-working offers



FOOTNOTES

1. Instant Group, Flexible Workspace Review – UK – 2017
2. Instant Group, Flexible Workspace Review – UK – 2016
3. Standard Life Investments Research – August 2017
4. Savills market data – 12 September 2017
5. The Flexible Revolution, Insights into European flexible Office Markets – CBRE Research – 2017
6. Instant Group, Flexible Workspace Review – UK – 2018
7. Colliers office market snapshot – September 2017
8. The Instant Group, Flexible Workspace Market Review – 2017
9. Colliers International Research – September 2017
10. JLL US research – 19 October 2016



are attractive, for large established corporations, security, confidentiality and noise levels remain high on their list of priorities. Corporations which are growing less dramatically will often favour durability and quality of workspace over the ability to customise a space at short notice. As the USPs of co-working are flexibility, collaboration and shared knowledge, accommodating the requirements of established corporations is a challenge.

Identity and brand also play an important role. Established companies have invested considerable time and effort in building up their brand, with a company's business location often playing a key role in its identity. It will be interesting to see whether co-working for growing companies has a shelf life – as a company's market presence and brand gains traction, its priorities may shift to

promoting its brand through its own independent office space.

LOOKING AHEAD

Industry experts forecast that demand for co-working spaces will continue to grow at an average of 10-15 per cent per annum and that, by 2030, 30 per cent of office space will be in co-working format.¹⁰ As companies and independent professionals become increasingly agile we expect that landlords will continue to adapt to user demands “future-proofing” their investments. In doing so, we may see landlords employ co-working providers' extensive market knowledge to manage their assets; WeWork for example has recently launched a new property management outsourcing service for landlords, which will deploy the user and technology services that have become synonymous

with co-working. Tapping into the private office market will further accelerate the growth of co-working providers. In London, action is also being taken at Government level: the City of London sub-committee's recommendations in relation to the “London Plan” (which sets out the development strategy for the capital) include policies to strengthen the provision of flexible workspace to suit the requirements of SMEs and address the issue of rising rents by introducing an affordable rents strategy. Within both the private and co-working office markets, maximising productivity and the cost-effective use of spaces remain key.



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Spanish market residential loans

New requirements in Spain

by Cristina Calvo

An Act, which is currently working its way through the Spanish Parliament, sets out a special legal framework for real estate purchases and their financing.

INTRODUCTION

During the real estate crash that followed the Great Financial Crisis, thousands of people around the world lost their homes when they became unable to pay their mortgages. This led to a review of the regulatory framework regarding the commercialisation of residential loans aimed at consumers, which in Europe has crystallised in EU Directive 2014/17. For its part the Spanish government announced a reform of the Mortgage Act in order to incorporate EU Directive

2014/17 into national law, but so far the only regulation processed formally, and which incorporates (although beyond the deadline and only partially) the provisions of said directive, is the Draft Act on real estate credits. This Act, which is currently working its way through Parliament, amends the legal framework of real estate lenders, but it also sets out a special legal framework for real estate purchases and their financing.

Whether through the amendment of the Mortgage Act, or through

the Act on real estate credits, the truth is that, based on EU Directive 2014/17, any credit intermediary intending to market loans for the purchase of housing in another country within the European Union (and this includes any real estate company) will have to submit to a verification process carried out by the relevant authority and be supervised throughout by way of prior registration in a registry that in Spain will be supervised by the Bank of Spain.

Additionally, the activities of real estate credit intermediaries linked to a sole lender will be supervised by the latter, who will be required to answer for any actions or omissions of an intermediary acting on its behalf, before the relevant authority.

Registration requires the following:

- a. Obtaining a professional liability insurance or bank surety;
- b. Having the minimum required knowledge of the products to be marketed, the level and certification as set by the Ministry of Economy, Industry and Competitiveness;
- c. Having written procedures in place and the technical and operational ability for compliance with the reporting obligations towards borrowers on contractual and pre-contractual matters regarding the intermediary itself, its remuneration, advisory services and out of court resolution mechanisms, among others;
- d. Being intermediaries of a recognised standard;

- e. Having the appropriate internal means in place for the out of court resolution of claims by borrowers;
 - f. Not having being found guilty of any serious crime, whether against the State or connected to the performance of any financial activities; and
 - g. Appointing a representative before the Executive Service of the Commission for the Prevention of Money Laundering and Monetary Infringements once money laundering requirements are met.
- When a Spanish intermediary wishes to carry out this activity in a different country within the European Union, it will have to inform the Bank of Spain, which in turn will notify the relevant receiving State. The recognition of a real estate credit intermediary by a member State will be valid in another EU country.

Credit intermediaries may not provide services in connection to credit agreements offered by non-credit institutions only to clients from a member State in which said institutions are not authorised to perform their activities.

HOW WILL THIS AFFECT BANKS AND REAL ESTATE COMPANIES?

Clearly, all developments on legislation introduced by this draft will have an impact on banks, albeit that many of the measures mentioned therein are already legally backed by several regulations, which means the impact for the banking sector will not be so severe.

Notwithstanding the above, there are certain aspects that could have a greater impact than others.

In the case of commissions, the draft sets out as a general rule that the only commissions to be received and expenses charged are those related to services that have been





formally requested and rendered in practice, or that are otherwise approved. That is to say, commissions must come from services rendered in practice, or from expenses actually made in the granting of the loan and must be certified. No fictitious figures are to be included that may be prejudicial to the borrower.

On the other hand, opening and early payment commissions are particularly highlighted. The former will be accrued at one time and will have to include all expenses arising from the analysis, processing and granting of the loan, or any other similar payments incidental to the borrower's activity derived from the loan grant. Concerning compensation for early payment, whether in total or in part, it sets out a specific regulation and limits to these, indicating that they must be based on the damage that the entity effectively suffers in practice for enabling early repayment.

As regards the so-called linked transactions (sale of a bundle made up of a loan agreement and other products), the general rule will be that these are banned unless if the borrower is offered the loan independently of the rest of the financial products in the bundle.

Finally, the draft puts particular emphasis on the training of employees and their remuneration. Obviously, this will force financial entities to thoroughly train their employees so they are knowledgeable about the products and services offered to borrowers, and can clearly explain the transactions. Let's not forget that the information provided by banking employees regarding so-called "preferential shares" was clearly insufficient due to their lack of understanding of these products by those marketing them, among other reasons. Moreover, the draft intends to avoid the fact



that the remuneration system of the borrowers' employees promotes entering into a certain type of agreement without taking into consideration the needs and interests of consumers.

In any case we will have to see how other rules of EU Directive 2014/17 of the utmost importance for the banking sector (as regards delays and mortgage enforcement, for instance) are incorporated into our legal system and which measures and control mechanisms are set in order to ensure compliance of said rules.

With regards to real estate companies, the possibility of acting as real estate credit intermediaries will obviously force them to comply with the aforementioned requirements. However, an interesting period will follow and we will see how they will perform and how their actions on behalf of lenders are articulated when it comes to undertaking loan agreements. They will obviously be duty bound to train their employees to effectively render the aforementioned services.

MAIN LEGAL DEVELOPMENTS OF THE REFORM

What are the most significant legal developments of the reform?

As highlighted in the introduction, the main goal of the reform will be to create a more transparent credit market that will increase the level of protection for consumers entering into loan agreements or credits in their purchase or maintenance of residential real estate.

The aim is to align Spanish legislation with European regulations to ensure consumers have a common framework that encompasses measures such as: (i) banning sales practices linked to loans (with some exceptions); (ii) imposing appropriate and comprehensive reporting obligations regarding concepts that are difficult to understand or that imply excessive risks for consumers, such as the operation and calculation of the AER, or the exchange rate risks of loans subscribed under a foreign currency; (iii) eliminating any potential conflicts of interests of residential credit market operators,

decoupling remuneration policies of said operators from the marketing of a particular quantity or type of credit agreements; (iv) ensuring that market operators have sufficient and appropriate knowledge of the products they market; (v) setting out clear criteria as regards general and contractual information provided to consumers who wish to take out loans for the purchase of housing, as well as the obligation to render advisory services oriented towards each consumer's need; and (vi) providing consumers with out-of-court solutions to settle disputes that may arise in the course of their relationship with market operators.

In essence, the reform is intended to restore consumers confidence in the credit market.



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Beneficial ownership

Register for foreign entities

by Alison Murrin

UK companies and LLPs are subject to rules which require them to identify and publicly record the identities of the individuals who own or control the legal entity on a “register of people with significant control” (a “PSC register”).

The rules are aimed at achieving transparency of the individuals who control companies and who previously may have been hidden behind opaque corporate or trust structures. Non-compliance is a criminal offence.

A person with significant influence or control of a company (a “PSC”) is an individual who meets one or more of the following conditions:

- holds, directly or indirectly, more than 25% of the shares;
- holds, directly or indirectly, more than 25% of the voting rights;

- holds, directly or indirectly, the right to appoint or remove the majority of the board;
- has the right to exercise, or actually exercises, significant influence or control; or
- holds the right to exercise, or actually exercises, significant influence or control over a trust or firm which would satisfy one of the first four conditions if it were an individual.

To date foreign investors have not been troubled by these rules but the government is casting its net wider

and intends to extend these rules to overseas companies (and other legal entities) that own or buy UK property.

The main proposals are as follows:

1. The new overseas PSC register will be held by Companies House and will be publicly accessible for free. On registration, and following the supply of the relevant information, an overseas company will be given a registration number. The current proposal is that the information will have to be updated once every two years and entities will need to include details of the all the changes since the last update.
2. The regime will apply to overseas companies who have owned or acquired registered freehold properties and leases for more than 21 years.
3. Companies incorporated in countries with equivalent domestic disclosure requirements to those under the proposed new regime will be exempt.
4. An overseas company that already owns UK registered property will have one year to comply when the regime comes in. After that time, it will not be able to sell, or otherwise deal with the property until it has complied (by virtue of a restriction that will be placed on the title register). The government is also considering whether to make it a criminal offence for those overseas companies that have not complied with the regime after one year.
5. An overseas company proposing to buy a UK property will not be able to register title without providing its Companies House registration number. Following registration, a restriction will be entered on the title register preventing a sale or grant of a long lease or mortgage

where the owner is not compliant with the regime.

6. Lenders may have difficulty enforcing security if they cannot exercise their power of sale because of the restriction on the registered title of a non-compliant overseas entity.
7. To prevent beneficial ownership passing to an overseas company on completion of a transfer prior to registration (where the company has not complied with the regime), one option being considered is to void the transfer.

We expect draft secondary legislation which will implement these rules will be published in the summer and the register will go live by 2021. A key message for the drafts person is that a disproportionate compliance burden may discourage foreign investment and a balance should therefore be struck.

The proposal to “void” a transfer made by a non-compliant overseas entity could have serious legal and practical consequences. We understand that the government has been persuaded to drop this measure but we cannot be convinced of this until we see the draft regulations.

Therefore it would be advisable for overseas real estate funds and joint venture entities to consider beginning preparation for the implementation of these new rules by identifying the relevant persons of significant control or influence as this may be quite time-consuming in light of the complexity of some holding structures.



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Treviso Hospital deal

Brings social impact investing to PPPs

by Carloandrea Meacci

A “social impact investment vehicle” was used on the Treviso hospital PPP project, which closed in July 2017, and on which Ashurst advised. This innovative feature may be suitable for replication in other infrastructure deals in Italy and elsewhere.

The Treviso hospital project financing charts new territory for social infrastructure PPP projects by adopting a financing structure under which a portion of the savings derived from the financing arrangements (and, in particular, the European Investment Bank (EIB) lending) is reinvested in social activities in the local community. As acknowledged by the European Commission and the European Parliament, this approach, which is entirely voluntary, i.e. not required by law, could act as a role model for other infrastructure projects,

whether social or not, both in Italy and elsewhere. It could also be a “plus factor” for bidders in any future public tenders.¹

The Treviso hospital project is the largest greenfield hospital to be developed in Italy in recent years following a wave of increased interest from infrastructure funds, banks and debt funds/institutional investors in the M&A and project bond/project financing of Italian hospitals, as set out in Table 1 overleaf.

Treviso is a small wealthy town in the Veneto Region (in north-east

Table 1: Italy's main healthcare PPP deals over the past two years

| Date | Type of transaction | Hospital | Parties |
|---------------|----------------------------------|--|---|
| August 2017 | M&A | Integrated Centre of Novara (Piedmont region) | Equitix (buyer) and Pessina Costruzioni (seller) |
| August 2017 | M&A | Mestre (Veneto region) | Astaldi (buyer) and Mantovani (seller) |
| February 2017 | M&A | Milan San Giuseppe (Lombardy region) | Multimedica (buyer) and Ente Morale Provincia Lombardo Veneta dei Fatebenefratelli (seller) |
| February 2017 | M&A | Three hospitals of Foggia, Potenza and Bisceglie (Puglia/Basilicata regions) | Universo Salute (buyer) and Congregazione Ancelle Divina Provvidenza (seller) |
| February 2017 | M&A | Legnano (Lombardy region) | Ardian (buyer) and HISI (seller) |
| March 2016 | Project finance | Verona - Borgo Roma and Borgo Trento (Veneto region) | Unicredit/MPS |
| February 2016 | M&A | Garbagnate Milanese (Lombardy region) | Equitix (buyer) and Pessina Costruzioni (seller) |
| January 2016 | Project finance/ Project bond | Udine - Santa Maria della Misericordia Hospital (Friuli-Venezia Giulia region) | Natixis, BNP Paribas |
| December 2015 | Project finance | Empoli (Tuscany region) | MPS |
| August 2015 | Project bond/ Project finance | Garbagnate Milanese (Lombardy region) | Natixis |
| July 2015 | M&A | Castelfranco Veneto and Montebelluna (Veneto region) | Equitix (buyer) and Guerrato S.p.A. (seller) |

Italy, near Venice) and an industrial hub for both a range of niche enterprises as well as international brands such as Benetton, Riello and Geox, many of which are leaders in their sectors, exporting a large proportion of their output to a global market. Investment in Treviso's social infrastructure is key to maintaining its competitive advantage internationally. The hospital serves the entire community in the province of Treviso, which has a population approaching

one million. The existing hospital was no longer fit for purpose and a large part of it needed to be rebuilt; also, both routine and intensive healthcare services, including day surgery, needed to be upgraded.

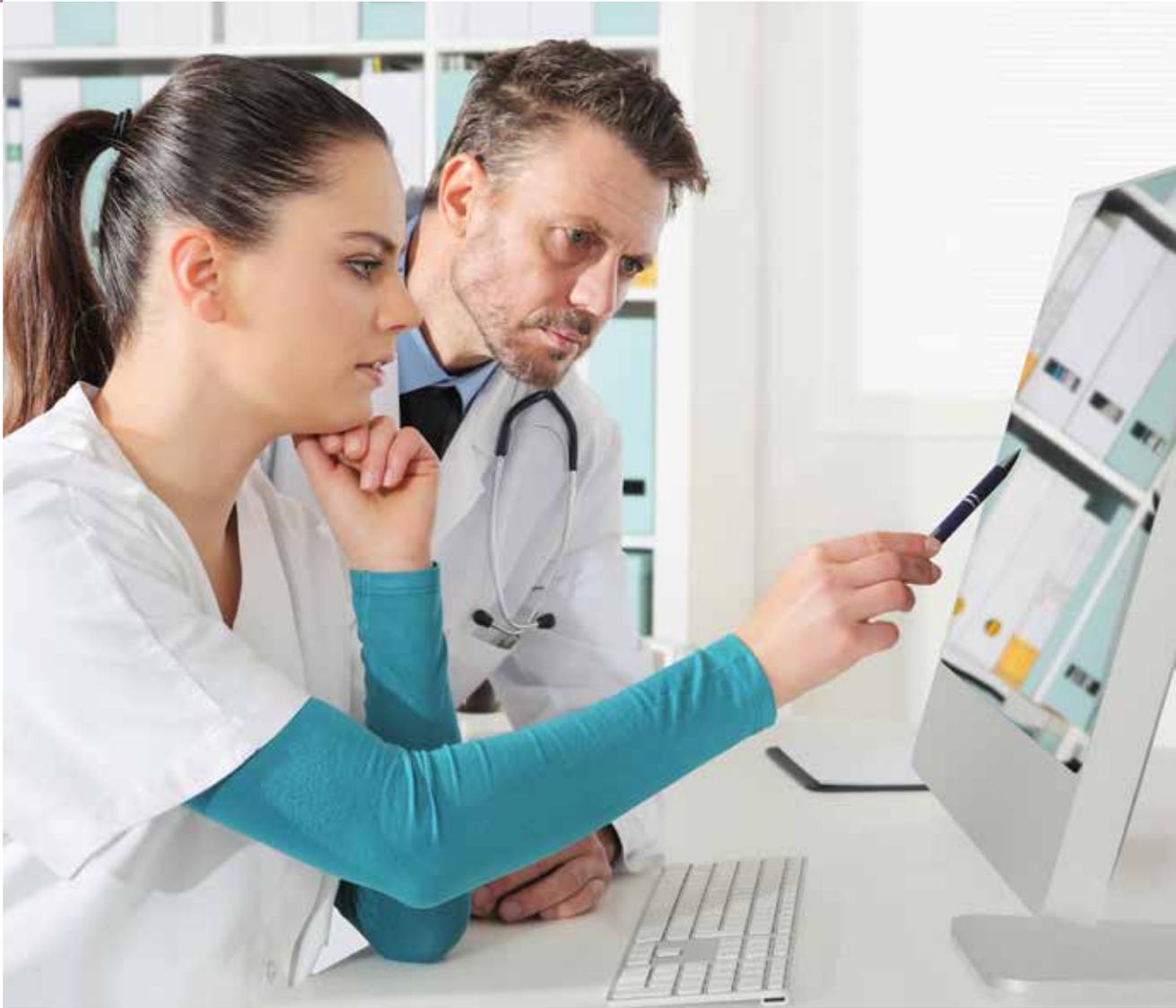
To renew and upgrade the hospital, known as the "Cittadella della Salute" (Hospital City), the Treviso Health Authority issued a tender for a 21-year PPP concession contract for a €250m 1,000-bed hospital, with the aim of creating a model hospital serving the

healthcare needs of the entire region. The concession is a classic Build-Operate-Transfer (BOT) structure, whereby the private sector party builds, operates and – at the end of the concession – transfers the hospital back to the authority. The financing sources are a mix of public grants during the construction phase, in addition to availability payments (*canone di disponibilità*) and payments for the provision of non-medical services during the operation phase. The balance of the financing is provided by the private sector party through a mix of equity and project finance debt.

As is standard for projects of this type, and as required by law, medical services are provided by the authority itself and not by the private sector party.

FOOTNOTES

1. European Parliament, Directorate-General for Internal Policies, Policy Department B: Structural and Cohesion Policies (2017); European Commission, Vision and Trends of Social Innovation for Europe (Filippo Addarii & Fiorenza Lipparini) (2017).
2. The SPV is 80 per cent owned by Finanza e Progetti, which is a vehicle 50 per cent owned by Lendlease and 50 per cent owned by Servizi Italia. The other 20 per cent ownership of the SPV is held by several industrial partners: SIRAM (10 per cent); Carron Italy (2.5 per cent); Bilfinger SE (2.5 per cent); Tecnologie Sanitarie (2.5 per cent) and Lendlease Construction (2.5 per cent).



In December 2015, the concession contract was awarded to Ospedal Grando S.p.A., a special purpose vehicle (SPV) led by Lendlease – a leading Australian infrastructure developer – alongside other financial and industrial partners.² This is the first time in Italy that the leader and majority shareholder of a concessionaire has been a “pure” developer and investor, rather than a construction company.

The construction contract has been awarded to a joint venture of two of the SPV shareholders, Carron (65 per cent) and Bilfinger (35 per cent).

The contracts for the services to be provided during the operation phase have been awarded to a number of the SPV shareholders and other entities, and include:

- soft facilities management, i.e. cleaning (Manutencoop), laundry (Servizi Italia), catering (Serenissima) and hospitality (i.e. all commercial activities within the hospital premises such as bar, restaurant, shopping and car park);
- hard facilities management, i.e. waste and energy (Bilfinger); and
- supplies and upgrade of medical equipment (Tecnologie Sanitarie).

Diagram 1 summarises the PPP structure for the project.

Following various upgrades to the design as a result of certain changes in law (e.g. compliance with new anti-earthquake legislation), works began in June 2017 with the construction of the emergency unit and helicopter pad. The main building is expected to be completed within four years, and the other facilities three years later.

The hospital will include 160,000 m² of floor space dedicated to healthcare provision, of which 105,000 m² will be new-build and

55,000 m2 will comprise upgrades to existing facilities, and will contain 200 day care surgeries. As tangible evidence of the upgrade, and most unusually for Italian hospitals, there will be a maximum of two beds per room, as opposed to the four – or eight – beds per ward which existed previously.

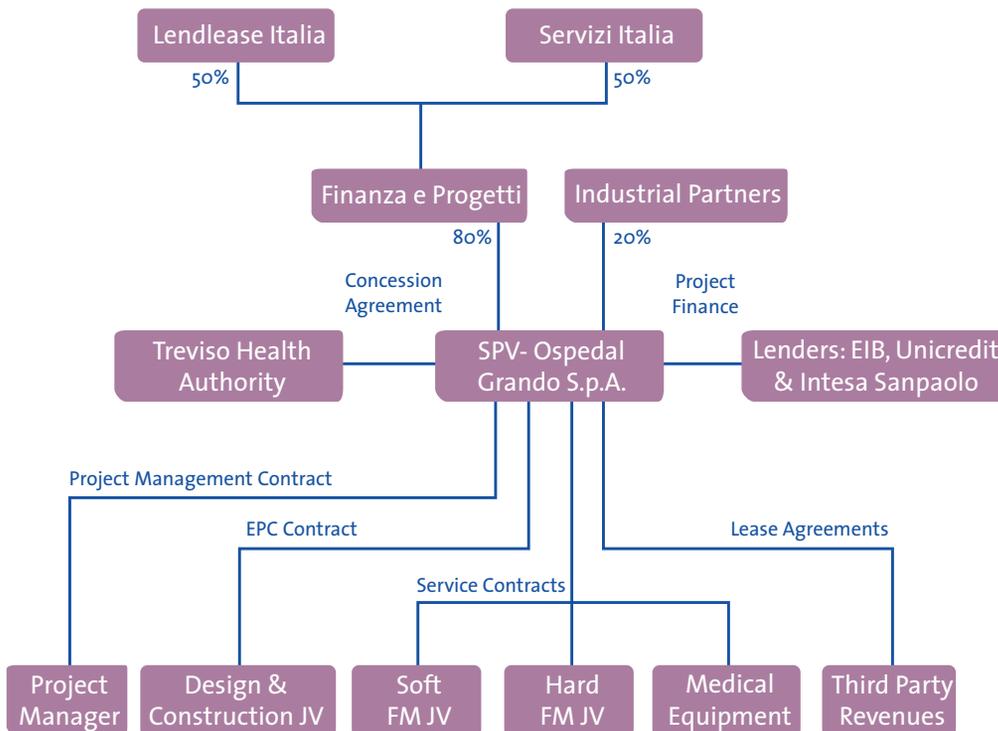
In July 2017, the SPV entered into a project finance loan agreement and related finance documents with the EIB as well as UniCredit, Intesa Sanpaolo (with Banca Prossima) as commercial lenders and Banca IMI. The debt package includes a term loan facility and a VAT facility (provided by commercial lenders) as well as a €29m loan from the EIB, which was granted under the framework of the European Commission’s Investment Plan for

Europe – known as the “Juncker Plan” – at a lower interest rate than that provided by the commercial lenders. In a novel arrangement, 100 per cent of those interest savings are being committed, not – as would normally be the case – as a dividend to the SPV’s shareholders, but to capitalise a new social impact vehicle entitled “Ospedal Grando Impact Investing”, which has been established to invest in social entrepreneurial initiatives relating to public health in the Treviso area and the Veneto Region, such as new e-health services. The thinking behind this arrangement is that this investment will start a virtuous cycle of further investments in the social impact vehicle, which in turn will trigger better services for the community and further commitment from community

stakeholders. In addition, it provides an opportunity for the SPV and its sponsors to test a new model for social infrastructure projects and to increase the attractiveness of their offering in a highly competitive infrastructure market.

On the one hand, this structure is similar to other local impact investment vehicles established elsewhere in Europe such as the Liverpool City Region Impact Fund and the Portugal Social Innovation Programme. On the other hand, this structure is a “market first” because it was conceived by the private sector and implemented through corporate venture capital. The EIB has acknowledged that the Treviso project is the first to be funded by the EIB where there has been an explicit commitment to use

Diagram 1: PPP structure for Treviso hospital project



the financial benefits derived from the EIB funding for social impact investing.

A number of legal structures were considered in order to implement these arrangements. Initially, the social impact vehicle was intended to be a subsidiary of the SPV. However, this would not have allowed full separation of the social impact vehicle and the SPV and would have raised a risk of failure to comply with the concession requirements. In the end, the social

impact vehicle was structured as a sister company to the SPV, owned by the main shareholder of the SPV (Finanza e Progetti), under which the SPV's savings derived from the EIB lending are transferred to the social impact vehicle as equity by means of a delegation by Finanza e Progetti (in its capacity as shareholder of both the SPV and the social impact vehicle) of the payment of special distributions deriving from the above-mentioned savings. Under the financing documents, such

special distributions are subject to specific distribution requirements compared to ordinary distributions.

Investments by the social impact vehicle must be made within a set period of time and must comply with certain social investment parameters agreed with the lenders. Compliance is checked by a firm appointed by the SPV or by the social impact vehicle with the consent of the lenders. In addition, the mission of the social impact vehicle is set out in its constitutional documents,

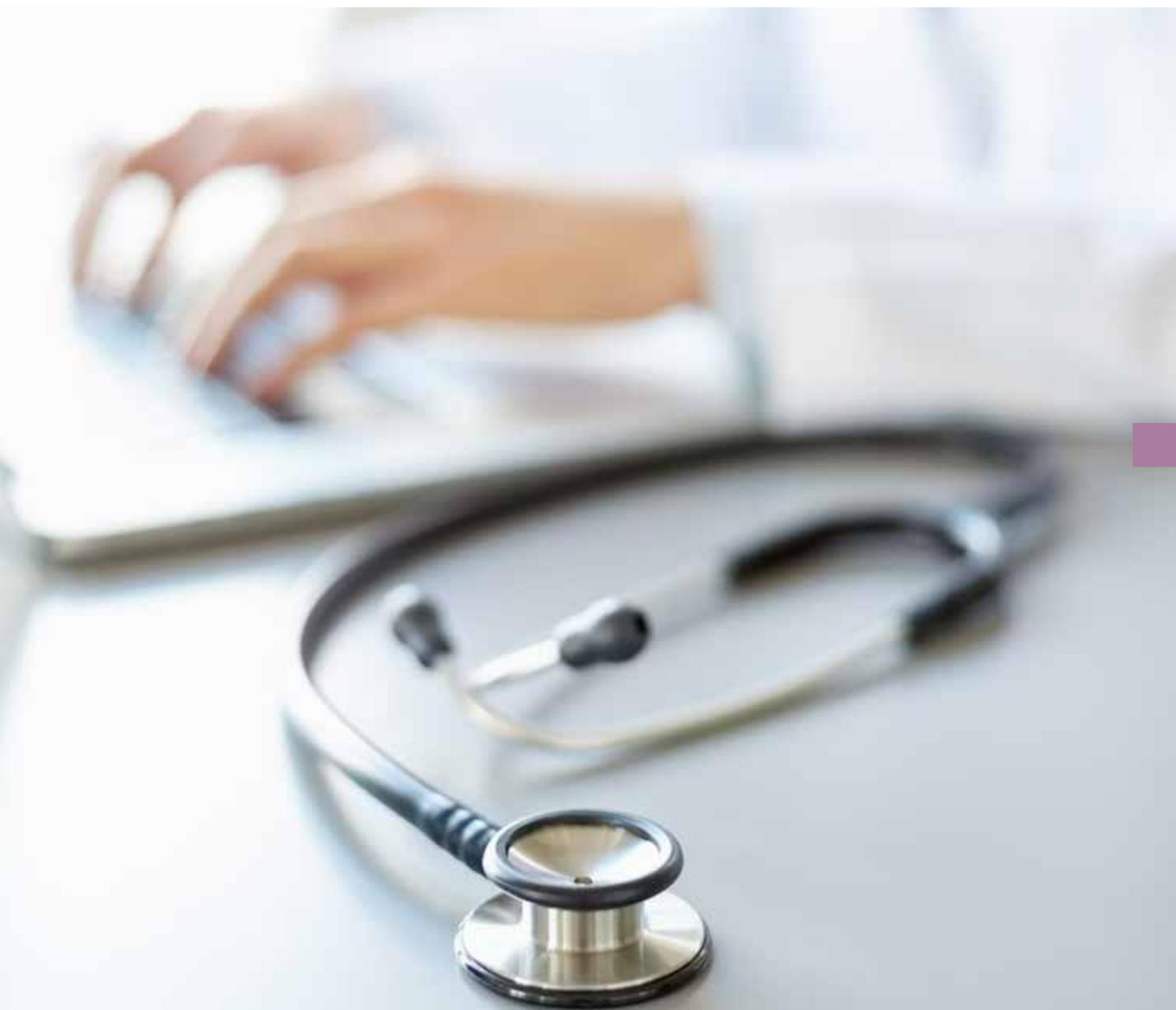
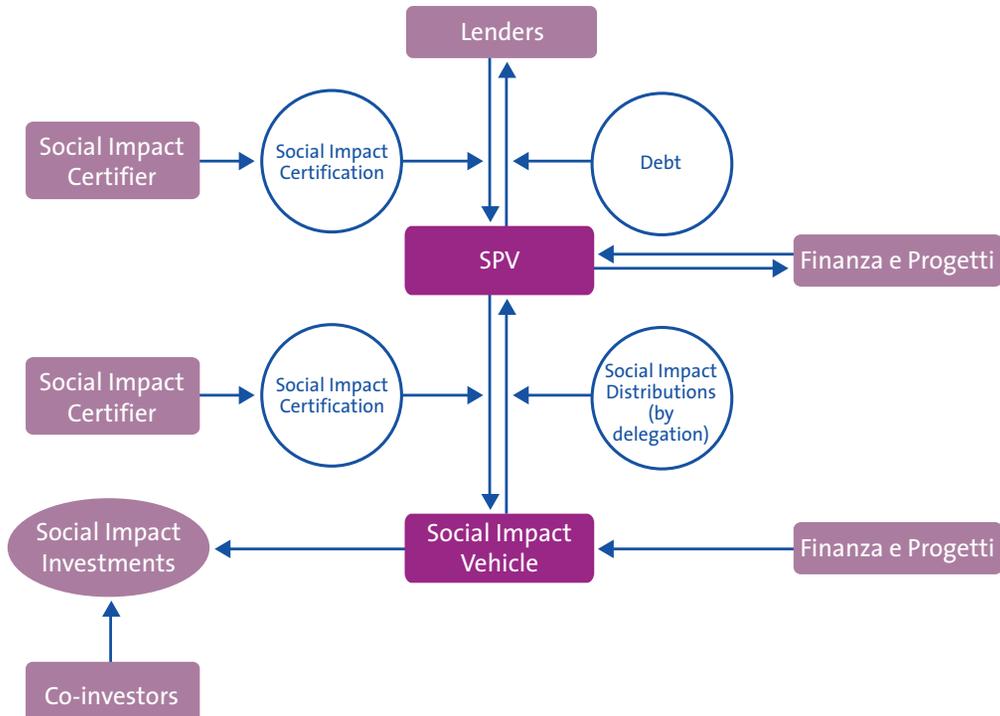


Diagram 2: Social impact investment structure for Treviso hospital project



which cannot be amended without the consent of the lenders.

The identities of the shareholders of the social impact vehicle and of the SPV are not required to continue to coincide but, if they cease to coincide, the social impact vehicle must be “kept whole” by the outgoing shareholder.

Diagram 2 above summarises the social impact investment structure for the project.

Another challenge raised by the structure is that savings from the EIB financing are not accrued upfront but over the duration of the loan, and therefore social impact distributions are potentially delayed,

which, in turn, could delay social impact investments. To mitigate this, the social impact vehicle may require its shareholders or external lenders to bridge this funding gap.

This factor, along with other features of the social impact provisions, makes the project structure quite unique in Italy in that social impact investments are achieved not through a not-for-profit organisation, a foundation, a philanthropic initiative or a corporate social responsibility programme, but through a for-profit vehicle.

This structure may prove a viable alternative option, or an upgrade option, for a number of PPP projects in Italy, particularly in the hospital sector, which has experienced significant growth in recent years.



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MEET ASHURST AT THE INTERNATIONAL HOTELS INVESTMENT FORUM 2018

Monday 5 – Wednesday 7 March 2018

Members of the Ashurst Hotels, Leisure and Gaming group are attending IHIF 2018. If you would like to arrange a meeting with one of our Partners to discuss a future prospect, please contact one of the team listed below or email Eleanor Thomas

The team attending are:

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MEET ASHURST AT MIPIM 2018

Tuesday 13 – Friday 16 March 2018

Members of Ashurst's market leading European real estate sector team will be attending the MIPIM conference from 13 – 16 March 2018. If you or your colleagues are attending MIPIM this year and would like to arrange a meeting with one of our Partners attending the conference, please contact a member of our team directly.

The team attending are:

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