

More flexibility in the structuring of a real estate fund under the Maltese legislation

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by Marco Degrada

GANADO Advocates is a leading full service business law firm based in Malta, widely recognised for its business and commercial law practices. The firm traces its roots back to the early 1900s, and is today one of Malta’s foremost law practices that is consistently ranked as a top-tier law firm in all its core sectors. GANADO Advocates has, over the past decades, contributed directly towards creating and enhancing Malta’s hard-won reputation as a reliable and effective international centre for financial and maritime services. Today, the firm continues to provide high standards of legal advisory service to support and enhance Malta’s offering. GANADO Advocates is Malta’s exclusive member for Lex Mundi, the world’s leading network of independent law firms.

2015 marked a clear recovery in the Global real estate market, thanks to the activity of asset management products focused on real estate. MondoAlternative spoke with **Andre Zerafa**, Partner at GANADO Advocates, about the new regulations that are changing the international real estate funds sector and the peculiarities of the Maltese jurisdiction.

According to Scenari Immobiliari, in 2015 investment funds were the main players of the real estate Global market. Have you noticed a growth and a greater dynamism of these instruments?

Over the last three years we have seen an increase of real estate funds investing in the mainstream jurisdictions typically in office blocks or tourism projects. We are also seeing the real estate funds getting more into high end or mid end residential projects. The strategies would normally be a mix of buy to let – this ensuring certain annual payouts to investors and ensuring that the fund’s costs are covered – and buy to sell. In the latter case, the sales strategy would take place over a divestment term of a number of years until the fund is all in cash, at which point there would be a final distribution to investors and the manager would also get his share of the returns. We are seeing funds investing either directly in the real estate market or else indirectly by acquiring notes issued by securitization companies in order to buy a portfolio of real estate assets.

What are the main services that you offer to real estate fund managers?

Over the years, we have structured real estate investment funds with diverse features, such as different drawdown terms, commitments, co-investments and lock-ins. We are also able to liaise with our legal correspondents in different jurisdictions in order to ascertain root of title to the property and advise the fund manager on the legal implications of the acquisition. We have put together a team of professionals which is focused on corporate governance

services to regulated entities – this team would assist the board in overseeing the investment structure through which the fund holds the real estate. We also issue legal opinions on capacity and validity of transactions to the financing banks and counterparties to real estate transactions and have extensive experience in this regard.

Today, what are the main needs and requests that real estate fund managers address to you?

Managers are becoming more creative on the types of structures which they are putting together. Some are particularly creative in their investment structure spanning across several jurisdictions. Funds of real estate funds are not so popular as far as we can see and managers have a preference of going directly into the market through joint ventures or by tapping into co-investment opportunities. One of the biggest challenges is liquidity management and, particularly, cash flow management. Managers are more conservative in their projections and no longer rely on money inflows in order to finance their ongoing expenses. At the same time, they are conscious that they need to keep their total expense ratio under close scrutiny because a spiraling of unforeseen costs would spell disaster in a type of strategy which is by definition illiquid. It is with these concerns that managers approach us in order for us to structure their investment products, ensuring that they stand the test of time.

What are the advantages that the Maltese law offer to real estate fund managers compared to others European Countries?

The AIFM Directive reduced regulatory arbitrage to a large extent. However, Malta offers interesting opportunities in view of the flexibilities which exist in the fund (AIF) products which can be structured under Maltese legislation. In fact, Malta is one of those unique jurisdictions which has combined a civil law/continental approach with an overlay of Anglo-

Saxon principles. Indeed, real estate funds can be set up in Malta as investment trusts, as contractual funds or as open ended or closed ended investment companies. MFSA rules recognize and regulate a system of commitments, closings, discounted shares and lock ins. These are all important tools which we use in structuring real estate funds. Furthermore, Malta has over 60 double tax treaties and could be used as a holding company jurisdiction for holding the underlying real estate. There also exists specific real estate expertise amongst lawyers, auditors and administrators in Malta which would assist the fund manager through various issues on legal title, valuation and the investment structure.

From a tax perspective, what does the Maltese law establish for real estate fund managers? Are there special exemptions or facilities?

All collective investment schemes licensed by the MFSA are exempt from paying any tax in Malta, unless they make investments in immovable property situated in Malta. On the other hand, the management companies are subject to tax on all their profits at 35%. Malta adopts the full imputation system and hence shareholders of Maltese companies are able to apply for a refund of the tax paid by the company. This refund typically amount to 6/7ths of the tax paid by the company in case that the company is an operating company like a fund manager. There is no special regime or exemptions for real estate companies and the same rules apply across the board to all types of operating companies. However, there are special tax rules which apply at a personal level to the so called 'highly qualified' persons – these would be expatriate individuals who live and work in Malta with fund management firms and who are occupying certain positions within the firm where a skills gap has been identified. In such cases the individual would, subject to the satisfaction of a number of basic conditions, pay tax at 15% of his or her income arising in Malta. This individual tax scheme was launched with the specific objective of attracting talented people to Malta in certain specific areas like risk management, operations, compliance, and investment analysis such that, with their experience, these people can then contribute to the spreading of knowledge with the ultimate objective of plugging the skills gaps which were identified by the Maltese authorities.

What are the most critical aspects of

the AIFMD for real estate fund managers?

In our view, the single most important and critical aspect of the AIFM Directive for real estate managers remains the valuation of assets. We have encountered situations where valuations vary greatly depending on the valuation agents which are appointed in the particular jurisdiction. Secondly, valuations do not always reflect market realities. We have seen several situations where the manager would try selling the property at the price fixed by the expert – which is also reflected in the net asset value of the fund – to find out that the market price is much less. This gives rise to a number of difficulties, particularly with investors, who would have been basing themselves on an unrealistic net asset value. Proof of title and proprietary ownership are also two sticky issues, especially when a fund has a strategy of investing in real estate across several different jurisdictions. The basic rule is that the law of the country where the immovable property is situated would apply and so, the fund manager would need to possess a healthy mixture of market knowledge, legal and tax expertise and planning know how.

In the last years, the Global real estate asset management industry have faced many legislative reforms, especially those regarding the creation and management of listed products and REITs. According to you, are still there some critical elements that should be corrected?

We believe that further regulation is required insofar as valuations of immovable property are concerned and as well as on the transparency of the structures which are adopted for the fund to purchase the underlying immovable property. In most cases, due to a number of reasons mostly relating to tax optimization, the investments are made through multi-layered structures set up in different countries, both offshore and onshore. Fund managers tend to just look through these structures since what is most important for them is the ownership of the underlying property. However, at times the structures used to achieve the investment purpose are not properly maintained and their corporate governance is completely ignored. Furthermore, we think that the directors of the fund should be made aware of the investment structure with all its details. Certainly, regulation could be introduced to address the governance of the board with specific reference to real estate strategies.