

# Offshore Advantages for Real Estate Investment Trusts ('REITs')

## Executive Summary

- The Channel Island Stock Exchange ('CISX') is a recognised stock exchange for H.M. Revenue & Customs purposes and as such a REIT listed on CISX meets the requirement for stock exchange listing.
- Listing equity securities on CISX is significantly more cost effective and time efficient than other eligible exchanges.
- REITs can avoid the need to have three year audited accounts by listing on CISX under the CISX investment funds listing rules.
- REITs structured as Jersey or Guernsey companies may utilise an expedited regulatory approach in relation to Listed Funds with approvals granted within three working days if eligibility criteria are met.
- Jersey and Guernsey tax law permits Jersey and Guernsey companies to be solely UK resident, when UK managed and controlled as required for REIT eligibility.
- Use of a Jersey or Guernsey company as a REIT will provide a more flexible companies law regime, including in relation to capital distributions and the statutory ring-fencing of liabilities to assets by use of an incorporated cell company.
- A Jersey or Guernsey incorporated REIT will not attract stamp duty on share transfers.
- Ogier Fiduciary Services has significant experience in administering public and private property funds, investment companies and trusts.

## INTRODUCTION

The REIT structure provides an attractive model both for real estate investment companies and UK investors looking for tax efficient property investment structures. Offshore jurisdictions offer significant advantages to investment managers and investors in the establishment and ongoing administration of REITs, as summarised in this briefing.

The most salient requirements from a corporate structuring perspective are that a REIT must:

- be a company;

- be closed ended;
- be exclusively UK tax resident;
- have only one class of ordinary shares (other than non-voting fixed rate preference shares);
- be listed on a recognised stock exchange;
- distribute annually at least 90% of property rental profits by way of dividend, to the extent lawfully possible;
- have no shareholder who holds more than 10% of the shares; and
- hold at least 3 properties (or separate rental units) with no more than 40% of the value in any one unit.

While there are numerous issues which need deliberation when considering a move to REIT status for existing groups or establishing a REIT without a previous trading history there are some key issues where the use of offshore jurisdictions and service providers may entail significant advantages to stakeholders.

## KEY ISSUES AND THE OFFSHORE ADVANTAGES

### Listing Requirement

In order to meet the listing requirement, a REIT must be listed on a recognised stock exchange under HMRC rules. As a REIT must be listed on a recognised stock exchange, for those not wishing to incur the expense and time commitment of a full London Stock Exchange ('LSE') listing, CISX provides a cost efficient and time effective alternative which may prove attractive.

In December 2002, CISX was designated as a recognised stock exchange by the Inland Revenue and as such a REIT listed on CISX will meet the listing requirement. As the AIM Market is not a recognised stock exchange for HMRC purposes, if a client is seeking to list a REIT in the UK it must do so in accordance with the UK Listing Authority's ('UKLA') Listing Rules applicable to a full LSE listing. This presents a number of commercial issues in relation to which investment managers and investors may find listing on CISX advantageous, as follows:

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- UKLA Listing Rules generally require three year audited accounts for trading companies seeking a listing of their equity securities. This makes the establishment of a "bespoke" REIT more difficult in the context UK listing requirements;
- a full UKLA listing is costly in part due to the extensive requirements of the UKLA Listing Rules;
- the UKLA approval process is lengthy;
- UKLA Listing Rules require the appointment of a sponsor which, in the context of a main market listing, can be costly and may not be commercially appropriate in every set of circumstances; and
- access to the liquidity of the main market of the London Stock Exchange plc ('LSE') may not be necessary depending on the structure of the transaction.

Listing a REIT's shares on CISX may alleviate these issues. If liquidity is sought, in addition to that provided by a CISX listing, this may be achieved without incurring the initial and ongoing costs associated with a full listing by combining a primary listing on CISX and a secondary listing on AIM.

CISX listing can be utilised by REITs incorporated in any of Jersey, Guernsey or the UK.

## CISX LISTING CONDITIONS

A REIT must be listed as an Investment Fund under Chapter 7 of the CISX listing rules (the '**Rules**'). Given the nature of a REIT, in particular that it is:

- required to distribute the majority of its property rental income;
- holds property for investment and not for trading or development purposes; and
- the investment of its assets represents a spread of investment risk (given its requirement to hold at least three properties with no more than 40% of the value in any one property),

it will be an investment fund for CISX listing purposes.

By way of summary, the conditions for an investment fund to list on the CISX are:

- that the investment fund must be duly incorporated in a jurisdiction recognised for the purpose by the exchange;
- must be able to satisfy the exchange that its directors together with any appointed investment manager have sufficient and satisfactory experience in the management of investments of the type in which the investment fund proposes to invest; and

- that the assets of the investment fund must be invested with the aim of spreading investment risk.

Given the requirement for the holding of at least three property rental units with no more than 40% of the value of the REIT in any one unit, this is a good fit, and REITs will be investment funds in CISX listing terms as long as they continue to satisfy the tests for REIT status.

The procedure for listing a REIT on CISX depends upon whether the REIT already has its shareholders and is not making an offer for further subscription, whether there is to be an offer to the wider public for subscription for shares or whether there is to be a limited and more private offer for subscription to a small select group of further investors.

Depending on the answer to those questions, an applicant may bring securities to listing as an investment fund by way of an introduction, by way of an offer for subscription or an offer for sale, or by way of a placement.

## INTRODUCTION

A listing by way of introduction would be made where the REIT has its shareholders and is not making an offer for further investors. The listing document would have to meet the content requirements for the listing rules, including a summary of voting rights, entitlements to dividends and such like, but many of the content requirements would not be applicable, and one is able to complete a non-applicability letter, for example in relation to the offer price and offer period, as there is no offer.

The reasoning for allowing a listing by way of introduction is that the securities are already widely held by the public, in other words their marketability can be assumed. This obviously comes down to an interpretation of what "widely held" means, and a REIT could have as few as eleven shareholders and comply with the rule that no one shareholder could have more than a 10% holding. A REIT held in that way could apply for a listing by way of introduction on those numbers.

The price at which the shares would be listed would be at the net asset value of the REIT, and it would be open to the REIT to create a market either through sales to third parties directly by the shareholders, or by the appointment of a market maker. The fact that there was no offer at the time of listing does not preclude any future trading.

## Offer for Subscription and Offer for Sale

An offer for subscription is an invitation to the public by or on behalf of an issuer to subscribe for securities of the issuer not yet in issue or allotted. The CISX needs to be satisfied in the case of an offer for subscription that the basis of the offer is fair and that every investor who

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applies at the same price for the same number of securities receives equal treatment.

An offer for sale is the same as an offer for subscription save that in the case of an offer for sale the offer is in relation to securities already in issue or which have been agreed to be subscribed.

In either case there will need to be a listing document but this will ordinarily be the same document as the offer document. Jersey counsel should be involved at an early stage in the drafting of that offer document to ensure that the necessary listing document content requirements are contained in the offer document.

## Placing

The final way in which to apply for the listing of a REIT as an investment fund would be by way of a placing. A placing is the obtaining of subscriptions for or the sale of securities by an issuer (or by an intermediary such as a Sponsor) privately from or to persons selected by the issuer or the intermediary. There cannot be a placing if there is likely to be significant public demand for the securities.

If a placing is permitted the CISX may require to be provided with a list of placees.

## Sponsor Requirements on CISX

No matter which method of listing one chooses, be it introduction, offer for subscription or sale, or placing, a potential applicant must make a listing application and must appoint a Sponsor who undertakes to accept the responsibilities of a Sponsor as set out in the CISX's listing rules. Ogier provide an in-house company which can act as sponsor in respect of any listing applications. This process marks the CISX out from the London stock exchange in that the Sponsor and exchange fees are much smaller. On a standard investment fund listing of a UK company we would expect the Sponsor and legal fees to be in the region of £10,000 plus annual fees of £1,500 for compliance with the relevant continuing obligations. An early sight of the offer or listing document would assist, in that we could ensure that the relevant CISX health warnings were incorporated. The CISX listing fees would be approximately £3,300. There is no requirement for a NomAd to be appointed or retained and this again is a significant fee saving.

## Accounts

There is a requirement on listing an investment fund in relation to providing previous year accounts. This will obviously depend on how long the fund has been established but the rules generally are that the investment fund applicant must have published audited accounts which cover the period of at least three years ending not

more than 12 months prior to the date of the Listing Document.

The CISX, however, can waive in whole or in part the requirement for three years of audited accounts:

- if the CISX is satisfied that the acceptance of accounts covering a shorter period is desirable and investors have the necessary information to make an informed judgment about the applicant;
- where the investment fund has been established for less than three years but more than 12 months in which case the audited accounts must cover the period from the establishment of the fund; and
- where the investment fund has been established for a period of less than 12 months the exchange may simply require the publication of an audited six monthly statement.

The accounting requirements can cause difficulties listing a new trading company as three years of accounts are generally required, and it is worth being aware of the ease of investment fund listing in this regard and the discretion in the hands of the CISX.

## OTHER REQUIREMENTS

### 25% public holding

On a listing of a closed ended investment fund at least 25% of the class of securities being listed must be in the hands of the public no later than the date of which dealings commence. The CISX can exempt this requirement but only if the fund has a sufficient number of units in issue to create a market in its securities.

For the purposes of this rule, a member of the public is not:

- a connected person (which means a director or controlling shareholder of the company or any of its associates or subsidiaries);
- any person whose acquisition of securities has been financed directly or indirectly by a connected person; and
- any person who takes instructions from a connected person in relation to the acquisition, disposal, voting or other disposition of securities of the issuer registered in his name or otherwise held by him.

### Directors

Two miscellaneous points to be aware of in relation to directors:

- the directors are responsible for the information contained in the Listing Document and must state such

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responsibility in the Listing Document, although the directors can confine their responsibilities on third party information to the proper extraction of the information from the sources shown in the Listing Document.

- on a closed ended investment fund the CISX requires that at least two of its directors be independent of any appointed investment adviser.

## Listing Process

Once the decision has been reached as to the method of bringing the securities to the list, the REIT can look to go through the listing process, which involves the submission of initial application documents and then final application documents. The initial application documents include the listing document in draft form, a certified copy of the Memorandum and Articles of Association of the company and such financial information as is available at the time. This will then be reviewed by the exchange prior to the final application documents being submitted, which include a formal application for the listing, a sponsors declaration, a standard form listing undertaking and the final form listing document and financial information as required.

## Cost and Flexibility

The Rules for listing shares on CISX are based broadly on the principles of the UKLA Listing Rules, and may therefore be familiar to investors and advisors but are significantly less onerous in application. CISX responds promptly and will consider an issuer's requests for derogations from the Rules quickly and commercially. CISX is also flexible as to the management of the transaction timetable. In our experience, the costs of listing securities on CISX are substantially lower than those associated with a main market listing in the UK.

## Jurisdiction of Incorporation of the REIT

To qualify for REIT status, a company must be tax resident solely in the UK and (*per* the UK Finance Act 2006) not "resident in another place in accordance with the law of that place relating to taxation". This does not mean however that only UK incorporated companies are eligible, under English law tax residency is determined by the place of a company's central management and control which is not necessarily its place of incorporation.

Jersey's principal tax law, was amended with effect from 1 January 2007 to confirm that a Jersey incorporated company will not be regarded as resident in Jersey for the purposes of Jersey's principal tax law, if:

- it is centrally managed and controlled in another jurisdiction, outside Jersey;
- it is tax resident in that other jurisdiction; and

- the highest rate of corporation tax in that other jurisdiction is 20% or above.

Under Guernsey tax law a Guernsey company can apply for exempt status from the Administrator of Income Tax on various grounds including that there are no shareholders that are resident in Guernsey. If the exemption is granted the company will be treated as non-resident in Guernsey. Under current proposals before the States of Guernsey it is expected that the rate of income tax for Guernsey companies (other than in respect of certain regulated banking activities) will be reduced to zero. It is currently proposed that exempt status may still be obtained for investment funds (such as REITs) which will mean that they will remain non-resident in Guernsey.

## What advantages flow from use of a Jersey or Guernsey incorporated REIT?

The use of a Jersey or Guernsey incorporated REIT may entail significant advantages over a UK incorporation. Jersey and Guernsey companies offer greater flexibility to investors as the respective Island's companies law utilise many of the same concepts as English company law (and will therefore be familiar to investors) but apply these in a less burdensome fashion.

## Capital Distributions

In particular, Jersey and Guernsey companies may be incorporated with no par value shares which can be redeemed or purchased by the company (subject to the terms of the issue of the shares and the company's memorandum and articles) out of its stated capital account (i.e. the equivalent of its share and share premium accounts) without recourse to its distributable reserves. Given that REITs will, by their very nature, be heavily utilising their distributable reserves due to the need to maintain an annual 90% distribution of property rental profits (to the extent lawfully possible), in the event that a REIT disposes of property and does not wish to reinvest it, a Jersey or Guernsey vehicle can allow for a more streamlined and cost effective return of capital to investors, without recourse to distributable profits, in these circumstances.

## Dividend Criteria

The criteria for the payment of dividends by Jersey companies, a key area for REIT eligibility, are proposed to be amended in 2007 to provide that dividends may be paid on the satisfaction of a cash-flow solvency test only. This would remove the current requirement (modelled on the English law position) to pay dividends out of distributable profits / reserves only.

The position in Guernsey remains similar to that in England, with dividends being payable from profits available for the purpose. However, it is a well established practice in Guernsey that profits may include

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unrealised capital gains, provided that unrealised losses are also taken into account.

## Abolition of prohibition on financial assistance

The flexibility of Jersey's companies law is proposed to be further enhanced by the abolition of the prohibition on financial assistance during 2007. Unlike the position under English law, post-2006 amendment, where financial assistance continues to be prohibited if provided by a public company (or a subsidiary of a public company), the abolition of the prohibition in Jersey law is proposed to extend to both private and public companies. This will entail significant transaction management advantages for Jersey public companies, which will include all Jersey REITs by definition as a result of the requirement for a stock exchange listing.

Under Guernsey companies law a Guernsey company is not prohibited from giving financial assistance, so long as it is permitted to do so by its memorandum and articles and will satisfy a statutory solvency test immediately after the financial assistance is given. Similar to the proposed changes under Jersey law, this flexibility provides significant transaction management advantages to Guernsey companies.

## No stamp duty on share transfers

Share transfers of companies incorporated in Jersey or Guernsey are not subject to stamp duty provided the share register is maintained offshore. Jersey and Guernsey companies are required by law to maintain their share register in the respective Island of incorporation.

## Cell companies - ring-fencing liabilities

Jersey and Guernsey REITs may also be structured as incorporated cell companies. A key innovation, a Jersey or Guernsey incorporated cell company provides separate legal personality for each cell. As a matter of substantive law (and not merely a procedural rule), this innovation is designed to ensure cross-jurisdictional recognition (including on insolvency) of the ring-fencing of each cell's respective assets and liabilities. In the real estate context this may be of particular relevance to asset-specific financing, and the ring-fencing of environmental and occupiers' liability to the property of individual cells.

## Expedited Regulatory Treatment

The combination of stock exchange listing and the REIT diversification requirements is likely to characterise a Jersey REIT as a collective investment fund under Jersey law and a Guernsey REIT as a collective investment scheme under Guernsey law. Expedited regulatory approval is available from the Jersey Financial Services Commission ('JFSC') in relation to such closed ended, listed, Jersey corporate funds meeting the criteria of the

JFSC's Listed Funds Guide. The principal criteria relate to the investment manager/adviser and the inclusion of certain prescribed information in the offer document required in connection with the listing. The investment manager/adviser will be approved if regulated for this purpose in an OECD member state and otherwise if sufficient track record and experience can be demonstrated to JFSC. Where the criteria of the Listed Funds Guide are met, JFSC aims to issue regulatory approvals within three working days.

Similarly in Guernsey, regulatory approvals may be obtained from the Guernsey Financial Services Commission ('GFSC') within three working days in relation to closed-ended Guernsey funds meeting the GFSC's 'qualifying investor fund' or 'registered fund' criteria. Similarly to the policy of the JFSC's Listed Fund Guide, the Guernsey 'qualifying investor fund' or 'registered fund' policy focuses on the administrator warranting that the promoter of the fund is fit and proper (after conducting its own due diligence) and various filing requirements.

## Expert administration

In relation to corporate administration, REITs have strong similarities to the public and private investment funds and property unit trusts currently administered in Jersey and Guernsey by Ogier Real Estate Services Limited ('ORESLS').

ORESLS provides administration services to a wide range of property holding vehicles including in excess of 200 unit trusts established over the last two years in respect of commercial real estate. In addition, ORESLS has wide experience in the administration of both public and private investment funds in both Jersey and Guernsey.

Ogier Corporate Administration Limited ('OCAL'), which is based in London, is regulated by the UK FSA and provides administration and operator services to UK tax resident real estate holding vehicles.

ORESLS currently administers real estate investment structures with assets under administration of in excess of US\$15bn and acts for many of the major property investment companies in the UK, opportunity funds and private investors. For further information, please see our recent deal list which is available on our website [www.ogier.com](http://www.ogier.com)



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## About Ogier

Ogier is an award winning offshore legal and fiduciary services provider. The group advises on all aspects of BVI, Cayman, Guernsey and Jersey law and associated fiduciary services through a global network of offices that cover all time zones and key financial markets.

Ogier continues to be recognised as a leading law firm by the principal legal directories, including Legal 500 and Chambers.

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