

UK REITs - the Government confirms changes will be made

The UK Government has given its initial response to the Budget REIT consultation ("UK Budget 2011 – Encouraging investment in Real Estate").

The main purpose of the REIT consultation was to identify changes to the rules that would encourage new investment in the real estate sector (particularly in residential property). The Government identified various changes that it was willing to contemplate, whilst also making clear that certain changes were outside the scope of the consultation – in particular, changes to allow private REITs. Comment was then invited – and received in abundance it seems. HM Treasury note that 53 written responses were received, from a range of sources, and that about 20 meetings were held with stakeholders.

We are told that all stakeholders saw the changes as a positive step. As a result, the Government are proposing the following:

- **Conversion charge:** The REIT conversion charge (2% of gross assets, payable on entry into the regime) will be abolished.
- **Listing requirement:** This will be relaxed to allow REITs to list on AIM and PLUS markets, and their foreign equivalents.
- **Close company requirement:** A "fixed" three year grace period will be introduced for a REIT to meet the "close company" condition (the condition that means the REIT must be widely held). There will be no discretionary extensions. Importantly, HM Treasury appear to have accepted that if, at the end of that period, the close company condition is not satisfied and so REIT status is lost, there will be no penalty for the "failed REIT" provided there are legitimate reasons for that failure.
- **"Diverse" institutional investors:** Certain types of institutional investor will be able to hold shares in a REIT without causing a breach of the close company requirement if they are "diversely owned". This should encourage "seeding" of a REIT by institutions.
- **No private REITs:** The Government has reiterated that the changes to the listing requirement are not intended to allow private REITs.

We do not yet have any indication of the types of institutional investor that could qualify as "diversely owned". As part of the consultation, interested parties pressed for a wide range of investors to be regarded as "institutions" for these purposes but we will need to wait until draft legislation is published in December 2011 to see HM Treasury's thoughts on this.

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In addition to the broader policy changes outlined above, the consultation also raised some "housekeeping" type changes to the REIT rules, the key issues being whether the profits/financing cost ratio should be changed and how cash deposits should be treated for the purposes of the balance of business test. For existing REITs, the news on these items is also positive. We are told that a change will be made to the profits/financing ratio to take into account interest on excessive borrowings only (rather than total finance costs). Further, cash will be treated as a "good" asset in the balance of business asset test. This is intended to allow spending decisions to be commercially, rather than tax, based. There is also likely to be an extension to the time limit for meeting the distribution requirement (from three to six months).

Next steps

In March 2011, it seemed clear that the Government expected to legislate some of its proposed changes in Finance Bill 2012. This recent announcement suggests that most, if not all, of the changes put out for consultation will be effected. This is very good news for the property industry.

However, there are still some unknowns – particularly in relation to the treatment of institutional investors – which should be resolved when the draft legislation is published. In keeping with the Coalition Government's Tax Policy Framework, the draft provisions will be made available for technical comment on 6 December 2011.

So, although the overall policy direction is very much to be welcomed, REITs and other interested parties will need to wait a little bit longer before they can assess the full impact of the changes.

This Client briefing does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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