AIFM. Solutions

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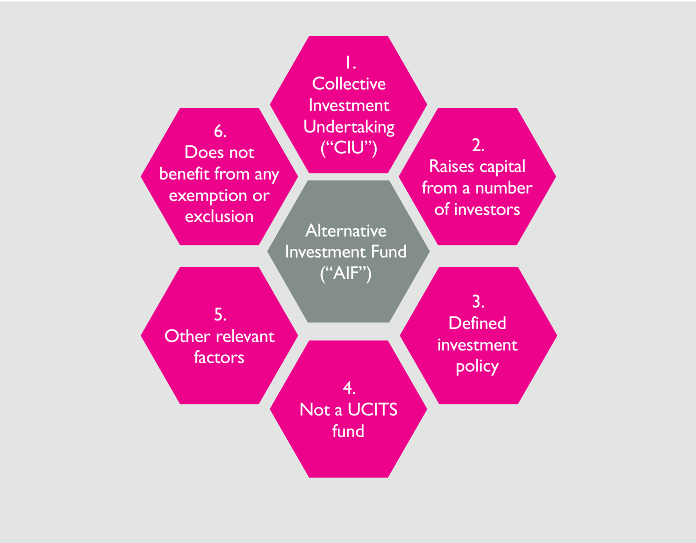
Real Estate structures - is there an AIF?

The extremely wide breadth of the definition of an AIF means that many structures which would not previously have been considered as funds will come within the scope of regulation.

ALTERNATIVE INVESTMENT FUND ("AIF")



Similarly, many structures which were collective investment schemes were able to appoint third party operators whilst retaining significant amounts of control. Whilst the FCA has worked hard to give practical and pragmatic guidance to firms, particularly in the real estate sector, it is already becoming apparent that more structures are becoming caught within the regulatory net than was previously the case prior to AIFMD.

In this section, we look more closely at the individual elements of the definition of an AIF in the context of typical real estate structures. In order to be an AIF, each of elements at 1 to 4 needs to be fulfilled. Real estate joint ventures ("JVs") may fall outside the scope of AIFMD, as may single investor structures. For other structures, including more widely held private funds as well as listed real estate vehicles, you have to apply the AIF definition to the specific structure and its commercial substance.

1 A key characteristic of a CIU is that it doesn't have a general commercial or industrial purpose. An entity is less likely to be a CIU if it has a continuous and evolving business model (as opposed to a defined investment policy) and its returns can be reserved, reinvested or distributed at its discretion. For some real estate structures, it may be possible to conclude that it is a trading business (for example, some listed REITs have taken this approach) but this is likely only to be the case where the structure is developing and operating the properties and not just acting on a buy and hold basis.

2 Where only a sole investor is allowed by the vehicle's constitution, and there is not more than one investor in the structure (i.e. the single investor is not a feeder fund, or nominee for more than one investor whose interests are aggregated), it will not be an AIF. This may be the case for some real estate structures.

3 Factors to take into account and which point towards having a defined investment policy include that the policy is fixed, and determined when investors commit; it forms part of the undertaking's rules or constitution; and it is legally enforceable by investors. Also, specific investment parameters point towards a defined investment policy. A JV's policy of achieving the parties' commercial goals is unlikely to be a "defined investment policy".

4 A UCITS fund is a type of authorised retail fund and is not within the scope of AIFMD.

5 Other indicative factors can be taken into account when the above analysis is not conclusive. These are essentially looking at whether, on balance, an undertaking has "fund-like" characteristics.

6 Various AIFMD exemptions may apply, e.g. for holding companies. Also, although there is no express exemption, JVs are not intended to be subject to AIFMD. The FCA has provided guidance which can be used to conclude whether particular types of JV structure would meet the different elements of the definition of an AIF set out in 1 to 5 above. The FCA guidance states that:

- a JV is generally an arrangement in which investors raise capital for joint investment and on their joint initiative, rather than where capital is raised and invested by a third party on their behalf - this would mean that the requirement at limb 2 above may not be met;
- a JV that does not raise external capital is not an AIF (e.g. where the same parties are raising and providing capital);
- where all parties have day-to-day discretion and control over the JV's activities the JV may not be a CIU. This means strategic, financial and operational matters relating to the daily management of the JV assets, and which goes beyond voting on ordinary shareholder matters; and
- JVs structured as limited partnerships can still fall outside the AIF definition, where the partnership business is managed by a general partner which is controlled (through the exercise of voting rights or appointment of board directors) by limited partner investors. This is because the economic participation (as investor) and strategic management and control (through the GP) are separated and carried on through different entities.

FSMA regulation and AIFMD

Where a fund is an AIF, you will need to ensure that it is managed by an AIFM and complies with AIFMD. This is the case whether or not it is also an unregulated collective investment scheme under s.235 FSMA ("CIS"). Where an arrangement is not an AIF but is a CIS, unless it is exempted from CIS status, it falls within the regulatory requirements of FSMA and you will need to appoint an FCA-authorised operator to carry out regulated activities.

The diagram on the next page illustrates the application of FSMA regulation and AIFMD to fund structures. The analysis of whether or not a structure is an AIF or a CIS differs, and therefore will need to be carried out separately. Note that other UK laws and regulations, and FCA rules, may also apply, and the AIFMD and FSMA analysis summarised above do not apply in isolation.

In the context of real estate structures which operate as JVs, many will fall outside the scope of AIFMD but are still subject to the regime for CISs and so would require an appropriately authorised operator to be put in place.

Small property UK AIFMs

In the UK, there are two different types of small AIFM: a small registered AIFM (either a small internal UK AIFM, a small property UK AIFM or an EuSEF or EuVECA manager) or a small authorised UK AIFM. The small registered UK property AIFM will be of interest to managers of unregulated CISs that invest the majority of their assets in land and whose assets under management ("AUM") do not exceed the relevant thresholds. These are: (i) €500 million of AUM where each of the AIFs an AIFM manages has no leverage and there are no redemption rights for the first five years; or (ii) €100 million of AUM for all other AIFMs.

Positives of being a Small AIFM are:

- it will be subject to less compliance and reporting requirements than a full-scope AIFM; and
- it will not be required to appoint a depositary to its AIFs, and will also not have to apply the AIFMD's requirements to its delegates or agents.

Negatives of being a Small AIFM are (and why some firms may choose to apply for full status straight away):

- many other EEA jurisdictions outside the UK do not fully recognise the Small AIFM regime. As a result, it may be difficult to market funds managed by a Small AIFM into other EEA jurisdictions; and
- if the value of AUM of the small AIFM increases to over the threshold set out above, it will become necessary for the AIFM to apply to become a full-scope AIFM and for all its existing AIFs to be fully-compliant.

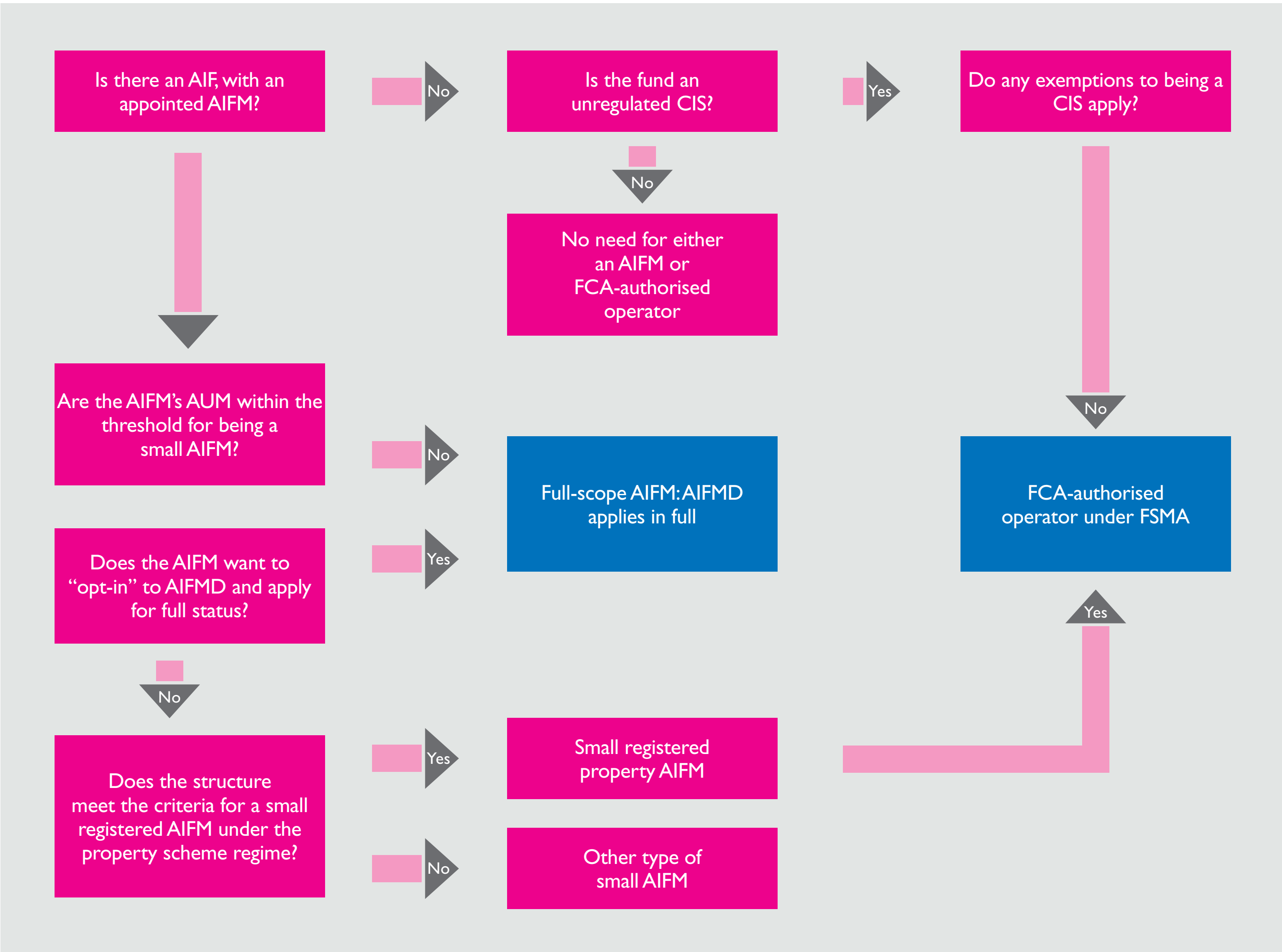
Our real estate and funds expertise

Our market-leading real estate practice combines international key sector knowledge, unparalleled technical ability and a commercial focus, which ensures clients receive the best possible support and guidance. Our team of 53 partners and 143 fee earners are consistently ranked highly not just in the UK but also in Russia, Abu Dhabi and Germany by the legal directories across the real estate disciplines. Our lawyers are recognised as experts in their fields. We can deliver the full spectrum of services, ranging from large-scale, complex residential property acquisitions to process driven work such as asset management.

Alongside our real estate practice, our investment management, tax, financial regulation, finance and corporate teams have an exceptionally deep understanding of the real estate sector. BLP's investment funds team is ranked Tier 1 - Investment Funds (Real Estate) in Chambers & Partners 2015. We are able to create highly effective teams, where each member appreciates the wider context of a project and the commercial objectives of our clients. Much of the work that we carry out for our clients requires an integrated, multi-disciplinary approach. We act for several of the most active fund managers and have well-established capabilities across a variety of alternative investment sectors, in particular, real estate, debt and infrastructure, as well as listed funds. We also have a strong investor fund review practice, giving us insight into the issues faced on both sides of the investment table.

We believe that the depth and breadth of our market-leading sector experience is what differentiates us from our competitors.

REAL ESTATE FUNDS REGULATION: AIFMD AND FSMA



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