Real Estate M&A

Contributing editor
Steven L Wilner

2018

GETTING THE DEAL THROUGH

GETTING THE DEAL THROUGH

Real Estate M&A 2018

Contributing editor
Steven L Wilner
Cleary Gottlieb Steen & Hamilton LLP

Publisher
Gideon Roberton
gideon.roberton@lbresearch.com

Subscriptions
Sophie Pallier
subscriptions@gettingthedealthrough.com

Senior business development managers
Alan Lee
alan.lee@gettingthedealthrough.com

Adam Sargent
adam.sargent@gettingthedealthrough.com

Dan White
dan.white@gettingthedealthrough.com

Law Business Research

THE QUEEN'S AWARDS FOR ENTERPRISE: 2012

Published by
Law Business Research Ltd
87 Lancaster Road
London, W11 1QQ, UK
Tel: +44 20 3708 4199
Fax: +44 20 7229 6910

First published 2017
First edition
ISSN 2514-4839

Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112

CONTENTS

France

Frédérique Chaillou, Raphaël Chantelot, Florence Defradas, François-Régis Fabre-Falret, Sandra Fernandes, Silke Nadolni and Chloé Thiéblemont

LPA-CGR avocats

1 What is the typical structure of a real-estate-related business combination?

This highly depends on the structure of the investor, whether it is a foreign or domestic investor, its final goal and its tax regime.

Depending on the above, several special purpose vehicles can been used:

- a regulated vehicle such as a French real estate investment trust (REIT) or a real estate collective fund (OPCI), which both benefit from tax exemptions;
- an alternative investment fund dedicated to real estate; or
- a special purpose vehicle such a real estate unlimited partnership or a limited liability company, which are simple vehicles designed to hold and rent real estate assets.

2 Describe the process by which real-estate-related business combinations are typically initiated, negotiated and completed.

In France, the process for acquiring a real-estate-related business is relatively standardised. Different terms would apply in case of purchase of a corporate vehicle owning the property. A share deal may be carried out according to a private sale and transfer agreement, without the participation of a public notary.

For major real-estate-related business a broker will be involved, whereby very often two brokers are appointed on a co-exclusive basis.

The first step is for the purchaser to send a letter of intent to the seller. This letter must be carefully drafted so that it may not be deemed to be a firm offer. The parties will only be bound once a call option or a bilateral undertaking to sell and purchase is signed.

It is customary to negotiate an exclusivity period during which the purchaser carries out all legal and technical due diligence over the real estate asset or the target company and the seller undertakes not to negotiate with any third parties.

Two types of preliminary contracts can be executed, a call option agreement and a bilateral undertaking.

A call option agreement is where the seller irrevocably undertakes to sell the property and the purchaser has the option of purchasing the property during the allotted time. In consideration of the option, the purchaser pays a deposit that is usually 10 per cent of the sale price. This deposit is not refundable if the purchaser does not exercise the option, but if he or she does exercise it, the deposit is deducted from the purchase price. However, the 10 per cent deposit is refunded to the purchaser if any of the conditions precedent stipulated in his or her favour are not fulfilled.

A bilateral undertaking to sell and purchase is where both parties are committed; the seller to sell and the purchaser to buy, but most often the transfer of title will be subject to conditions precedent. It is normal practice for the purchaser to pay a deposit (usually 10 per cent of the price), which will be refunded if the conditions precedent are not satisfied. Once the conditions precedent are met, the sale is final and the registration duties or taxes must be paid within one month, or the notarial deed of sale must be executed within such a period.

Notaries are necessarily involved in the conveyancing procedure relating to direct real estate investments (ie, purchase of the property as opposed to purchase of the shares of the company owning the property). This is because the direct purchase of a property must occur by means of a notarial deed of transfer in order to be published at the Land Registry so as to be enforceable against third parties and notaries have a monopoly in this respect.

The notary will draw up the contract (though lawyers are very frequently involved as well), witnesses the signature, collects and pays out the purchase price and publishes the transfer. The choice of notary is usually in the hands of the seller (or the lender for a loan). The notary's fees are payable by the purchaser unless the parties agree otherwise.

3 What are some of the primary laws and regulations governing or implicated in real-estate-related business combinations? Are commercial, residential or agricultural real estate assets subject to specific regulation that would be material in a typical transaction?

The primary laws governing or implicated in real-estate-related business combinations in France are mainly the French Civil Code, it being specified that depending on the underlying asset other regulations may apply: the French Commercial Code governs commercial leases; residential leases are governed by the provisions of Law No. 89-462 of 6 July 1989 and the Rural and Sea Fishing Code governs agricultural real estate assets.

4 Are there any specific regulations relating to cross-border combinations or foreign investors or acquirers that are material to real-estate-related business combinations and related structures?

French law does not impose restrictions in connection with the acquisition of real estate located in France by foreign persons. Individuals and legal persons, whether French or foreign, are free to purchase real estate in France directly or through a special purpose vehicle. Certain operations, however, may require filing formalities in the case of setting up of a company by non-resident or the acquisition by non-resident of a French company.

According to the Decree dated 7 March 2003, real estate investments in France made by foreign (ie, non-resident) investors that exceed €15 million must be declared to the Bank of France.

Such declarations are required for statistical purposes, failing which heavy sanctions provided in the Customs Code may apply.

Foreign entities with an establishment in France are deemed residents.

5 What territory's law typically governs the definitive agreements in the context of real-estate-related business combinations? Which courts typically have subject-matter jurisdiction over a real-estate-related business combination?

French law governs asset and share deals. Commercial courts have subject-matter jurisdiction over share deal whereas civil courts have subject-matter jurisdiction in case of asset deals.

6 What information must be publicly disclosed in a public-company real-estate-related business combination?

There are two kinds of public-company real-estate-related business combination: the OPCI and the civil property placement company (SCPI). Both require an administrative agreement from the French Financial Markets Authority (AMF) prior to any investment from the public.

Concerning the OPCI, the information disclosed to the public is communicated through two documents from the AMF or the distributors of the investments: the key investor information document (KIID) and the prospectus.

Concerning the SCPI, the annual report and the quarterly reports can be accessed by anyone who asks the management company for these documents.

7 Give an overview of the material duties, if any, of the directors and officers of a company towards company stakeholders in connection with a real-estate-related business combination. Do controlling shareholders have any similar duties?

Directors or officers of classic real estate companies (whether limited or unlimited liability companies) are not obliged by the company's shareholders to perform specific duties.

However, specific rules do apply to OPCIs, which are regulated fund vehicles commonly used for real-estate-related business. The OPCI director is necessarily a management company approved by the AMF. An OPCI is subject to the following distribution obligations:

- rental income: 85 per cent ;
- net capital gain on sale of building: 50 per cent;
- dividends from subsidiaries subject to the SIIC regime: 100 per cent;
- no distribution obligation for other income.

A subsidiary of an OPCI, such as an SAS or SARL, has the possibility to choose the SIIC regime under certain conditions resulting in an exemption of the rental income, capital gain on the sale of building and dividends of the subsidiaries subject to the SIIC regime, subject to distribution requirements of respectively, 95, 60 and 100 per cent.

8 What rights do shareholders have in a public-company real-estate-related business combinations? How do acquirers address and structure around the risks associated with shareholder dissent in the context of real-estate-related business combinations?

Unlike in other European jurisdictions, French law does not require that the shareholders of a public company approve going-private transactions in a general meeting. The possibility to delist the target company depends on the ability of the bidder to acquire 95 per cent or more of the securities and voting rights of the company. If this threshold is reached, the bidder will be entitled, under the control of the AMF to proceed with a squeeze-out transaction, with no shareholder approval required.

In the context of a squeeze-out, minority shareholders benefit from specific protections designed to ensure that they get a fair price for their shares. First, the price offered in a buyout offer (ie, an offer aiming to reach the 95 per cent squeeze-out threshold) following a tender offer pursuant to which a bidder has acquired the control of the target company must be at least equal to the price offered in the prior tender offer. Second, and in all cases of buyout offers where the bidder has indicated that he or she will, or may, proceed with a squeeze-out if he or she reaches the 95 per cent squeeze-out threshold, the price offered needs to result from a valuation made according to a multi-criteria analysis confirmed by a fairness opinion delivered by an independent expert.

The need to reach the 95 per cent voting rights threshold in order to implement and the squeeze out transaction and to successfully take the company private will usually push potential bidders to approach the key shareholders of the target to obtain from them undertakings to tender their shares in the upcoming tender offer.

A valuation from an independent expert may also be sought or required in transactions other than buyout offers and squeeze out transactions when there is a potential conflict of interests or in the case of risk of breach of the requirement for equal treatment of the shareholders. This will allow the controlling shareholder to avoid or minimise the risk of a minority shareholders challenging a real-estate-related business combination in court.

9 Which kinds of termination fees are permissible, and what is their magnitude?

It is not customary to have pre-agreed break-up fees during the negotiation period. The Civil Code provides for a negotiation in good faith. A party could, however, claim damages, should it consider that the other party acted in bad faith by having wrongfully terminated the negotiation. The amount of the indemnity is usually capped to the costs exposed during the negotiation period.

After execution a promise to sell for asset deals or a share purchase agreement, break-up fees usually correspond to a maximum of 10 per cent of the underlying asset's value.

10 How much advance notice must a public target give its shareholders in connection with approving a real-estate-related business combination, and what factors inform this analysis? How is shareholder approval typically sought in this context?

When a large-scale transaction is contemplated involving the sale of a substantial part of the assets of a listed company or a major change in its business, it is recommended that the listed company convene a shareholders' meeting to approve such transaction. The AMF has made such a recommendation, for instance for transactions involving the sale of assets representing at least half of the assets of the company. Such shareholders' meeting must be convened with at least a 30-day advance notice and must vote according to the conditions of quorum and majority of an ordinary general meeting. Although this is not a statutory requirement, should the board of the company decide not to comply with this recommendation, it shall justify its position to the AMF, which will exercise close scrutiny. In addition, minority shareholders may in such situation request the AMF to require the controlling shareholder to launch a buyout offer.

11 What are some of the typical tax issues involved in real-estate-related business combinations and to what extent do these typically drive structuring considerations? Are there certain considerations that stem from the tax status of a target?

Real estate structuring is mainly driven by how the capital gain will be taxed upon sale. In all the tax treaties concluded by France, the right to tax the capital gain on a building is given to France: when the seller is a non-French-resident company, the capital gain is subject to a 33.3 per cent levy comparable to the CIT rate to which French tax-resident companies are subject on the same capital gains.

The situation is slightly different for the capital gain realised upon sale of shares in French real-estate-oriented companies. Indeed, in some tax treaties the taxation of such capital gain is not given to France. With appropriate structuring and provided that economic substance exist, taxation of such capital gains can be minimised. That is why until 2014, most of the real estate funds were structured via Luxembourg, the Luxembourg tax treaty applicable until that date preventing France from taxing capital gains on shares of real estate companies. However, the France–Luxembourg tax treaty was modified in September 2014 to give France the right to tax all capital gains relating to French real estate business (buildings, shares in real estate companies).

The structuring of real estate business evolved and most of the major real estate funds set up OPCIs, which are regulated vehicles fully exempt from corporate income tax under certain conditions.

One other typical tax issue is the 3 per cent tax. All entities (French or foreign) holding a real estate asset in France directly or indirectly are liable to an annual 3 per cent tax calculated on the fair market value of the asset. A lot of exemptions are applicable. While structuring a real estate transaction, it is essential to check the 3 per cent tax status of the investors to ascertain that an exemption is applicable.

12 What measures are normally taken to mitigate typical tax risks in a real-estate-related business combination? How important are tax issues in evaluating structuring alternatives in the context of a real-estate-related business combination?

The French tax administration is allowed to challenge an operation and a structure if its purpose is mainly tax driven (abuse of law). This must be kept in mind while structuring a real estate transaction to minimise the tax leakage. It is essential to give economic and material substance to a structure to avoid a challenge of the structure under the abuse of law principle.

13 What form of acquisition vehicle is typically used in connection with a real-estate-related business combination, and does the form vary depending on structuring alternatives or structure of the target company?

The typical vehicle used to acquire real estate assets is an unlimited real estate partnership (SCI). From a tax standpoint, and provided that the SCI does not run a commercial activity, an SCI is a pass-through entity meaning that its taxable result is not taxed at its level but at the level of its partners. With an SCI the corporate income tax liability remains at the level of the existing partners at the closing date of the fiscal year. Therefore, this vehicle allows a reduction of buyers' tax liability. In addition, a seller is not necessarily required to grant a discount for latent tax while selling an SCI.

The acquisition of a building with a view to rent it is not a commercial activity. But the acquisition of a building with a view to resell it shortly after or the rental of a furnished building are commercial activities.

The other typical vehicle for real estate acquisition is an OPCI, which is a vehicle fully exempt from corporate income tax provided that it distributes most of its income to its partners.

14 What issues typically face boards of real-estate-related public companies considering a take-private transaction? Do these considerations vary according to the structure of the target?

Boards of public companies faced with a tender offer must be careful to exercise their fiduciary duties of care and diligence. This will require the involvement of advisers (investment banks and lawyers) capable of assisting the board in its assessment of the offer received, which will materialise in the prospectus in response that the target of a tender offer must issue in response to the bidder's proposed takeover. In that context, the assessment of the adequacy of the consideration proposed by the bidder is a key element, and boards may use the advice of an independent expert to confirm the fairness of such price.

15 How long do going-private transactions typically take in the context of a public real-estate-related business combination? What are the major milestones in this process? What factors could expedite or extend the process?

In France, the legal regime governing the delisting of a public company is more restrictive than in other European jurisdictions. For instance, French law also requires that the bidder in a buyout and squeeze-out offer holds at least 95 per cent of the capital and voting rights of the company, while the threshold required by the European Takeover Directive is only 90 per cent.

In addition, the timeline may be longer than in other jurisdictions. For instance, in order for a buyout offer to obtain clearance from the AMF to launch, the bidder must provide explanations (in the prospectus) regarding the methods followed by its sponsoring bank in the calculation of the offer price, and an opinion by an independent expert confirming the fairness of such price. This will obviously require substantial preparation.

After the buyout offer is cleared by the AMF, the process becomes faster: the buyout period must remain open for a minimum period of 10 days; when the results of the offer are announced, and if the 95 per cent squeeze-out threshold is reached, the AMF will authorise the squeeze-out and, after the required formalities and publications are carried-out, it may be implemented within a few trading days.

16 Are non-binding preliminary agreements before the execution of a definitive agreement typical in real-estate-related business combinations, and does this depend on the ownership structure of the target? Can such non-binding agreements be judicially enforced?

Parties usually sign a non-binding letter of intent for the direct or indirect purchase of real estate property. Such document is usually the first document entered into in relation to a property transaction and provides for the purchase price, tax aspects as well as the main terms and the conditions of the transaction (exclusivity period, due diligence, conditions precedent, timing of the transaction, etc). Non-binding agreements cannot be judicially enforced.

17 Describe some of the provisions contained in a purchase agreement that are specific to real-estate-related business combinations? Describe any standard provisions that are contained in such agreements.

The purchase agreement will contain all necessary terms and conditions of the transaction (description of the real estate asset, purchase price – including for share deal, price formula and procedure of determination of the final purchase price – a list of conditions precedent if any, covenants of the seller during the interim period, pre-closing operations, closing deliveries, representations and warranties, indemnification and guarantee deposit).

A recent trend is for the sellers to give limited representations and warranties. The scope of warranties and indemnities depends on the specificities of the transaction. As a minimum, the seller warrants the title to property.

18 Are there any limitations on a buyer's ability to gradually acquire an interest in a public target in the context of a real-estate-related business combination? Are these limitations typically built into organisational documents or inherent in applicable state or regulatory related regimes?

There are certain constraints, particularly in terms of disclosure obligation, bearing on the ability of a potential bidder to gradually build a stake in a listed company.

French law provides that any person, acting alone or jointly with other persons, who comes to hold more than 5, 10, 15, 20, 25, 33.33, 50, 66.66, 90 or 95 per cent of the share capital or voting rights of a listed company must, within five trading days, inform the company and the AMF that it crossed such threshold. Such information will be made public by the AMF. Failure to comply with such requirement will deprive the bidder of the voting rights exceeding the relevant threshold for a two-year period following the date of actual disclosure.

In addition, French companies may increase such disclosure requirement in their by-laws and require that disclosures be made for crossing thresholds between 0.5 and 5 per cent of their share capital or voting rights. Such additional disclosures must be sent to the company but they are not required to be disclosed to the AMF and to the public.

It is also worth noting that the price at which the shares are bought on the market may become a minimum price in a possible subsequent offer. Indeed, if the bidder comes to hold more than 30 per cent of the share capital and voting rights of the target, it will be required to launch a mandatory tender offer for all the shares of the target. In that case, French law provides that the price offered in such tender offer may not be lower than the highest price paid by the bidder for shares of the target over the 12 preceding months. The minimum price will also become the mandatory minimum price in a possible subsequent buyout offer.

19 Describe some of the key issues that typically arise between a seller and a buyer when negotiating the purchase agreement, with an emphasis on building in certainty of closing? How are these issues typically resolved?

The purchase process is usually divided into two main steps:

- an open bid process at the end of which an exclusivity period is granted to one candidate (sometimes an intermediate period is open with two candidates); and
- an exclusivity period (two to four months) at the end of which a purchase agreement must be executed.

The French market is currently a vendor's market (ie, there is strong competition between buyers that puts the vendors in a very favourable situation in terms of price and negotiation).

Several issues may arise, as discussed below.

Solvability

The French market does not accept any condition precedent relating to a bank financing. Buyers need to provide evidence that they have the financial capacity to pay the purchase price.

Timing

Buyers have to be able to complete the purchase process in a very short time period, since due diligence and negotiations are usually completed within two to four months. Such timing may be extended

depending on the negotiation, the quality of the information provided by the seller or any other reasons.

Limited representations and warranties
Buyers have to be very pragmatic and efficient in negotiating the representations and warranties.

20 Who typically bears responsibility for environmental remediation following the closing of a real-estate-related business combination? What contractual provisions regarding environmental liability do parties usually agree?

In France, responsibility for environmental remediation may be borne by different persons, depending on the situation.

If a regulated facility (ICPE) has been or is currently operated on the sold property, the last operator (or its beneficiary) of the facility that caused the pollution has the administrative obligation to remediate the site upon termination of activities to ensure its compatibility with a set use (industrial use will be assumed most of the time).

If the sale of an operated site entails a change of operator of the facilities, the new operator who inherits the site's activities is liable for future environmental remediation, provided that such remediation is related to the activities taken over.

Finally, if environmental remediation is required because of a change of use of the site, the person responsible for such change of use will also be responsible for the corresponding environmental remediation.

If no regulated facility has been operated on the site, the waste producer who contributed to the origin of soil pollution or the waste holder whose fault contributed to such pollution will bear the remediation obligation.

In all cases, the landlord may have residual liability when the above-mentioned primarily responsible persons have disappeared; and if the landlord is proven to have been negligent or if he or she contributed to the pollution of the site.

The administrative environmental remediation obligation may only be transferred, under specific conditions, through an administrative procedure implying inter alia prior authorisation from the Préfet and the constitution of financial guarantee. It should be noted that, even if the administrative environmental remediation obligation cannot be contractually transferred, specific remediation cost allocation may be agreed between the parties.

21 What other liability issues are typically major points of negotiation in the context of a real-estate-related business combination?

The seller of a property (asset deal) must provide the purchaser with two warranties, different in scope, covering the risks of eviction and hidden defects in the building sold. In practice, clauses are often inserted into contracts that limit the seller's warranty or even exclude it altogether. Such clauses are invalid if they emanate from a seller who is a professional, unless the purchaser too is a professional, specialising in the same field as the seller. Recent laws have imposed a requirement to append various schedules either to the pre-contract or to the notarised deed of sale, which relate to the risks attached to the property, such as termites, lead or asbestos.

Warranty against eviction
The warranty against eviction is a guaranty granted by law that covers the risk of eviction (ie, by third parties or by the seller). The seller firstly guarantees the purchaser against any direct claims to his or her property, such as seeking to evict him or her on the grounds of adverse possession or claiming rights in rem to the building, such as usufruct or building lease. The seller also guarantees the purchaser against any indirect actions against his or her property, such as selling the property to a third party before the first sale is registered.

Warranty covering hidden defects
After the sale, the purchaser may discover that the building sold contains a hidden defect: this is defined by the Civil Code as a defect that makes the building sold unfit for the purpose intended by the purchaser, or impairs this to such an extent that the purchaser would not have acquired it, or would have offered a lower price for it, had he or she known this. The purchaser is then entitled to apply for annulment of the sale accompanied by a refund of the price paid, or to receive a reduction of the price. The seller is not required to issue warranties covering any apparent defects. The extent to which a defect is deemed not to be apparent depends primarily on the extent of the purchaser's experience in detecting such defects. The purchaser may first seek the annulment of the sale. However, he or she may also apply to the courts for a reduction in the price of the property. Whichever course of action he or she chooses, the purchaser must act no later than two years as from the date on which he or she discovered the defect.

22 In the context of a real-estate-related business combination, what are the typical representations and covenants made by a seller regarding existing and new leases?

Investment in property tends to be for commercial or offices use. A lease agreement for this use will fall into the scope of the commercial lease regulations. The main purpose of the French regulation is to grant the lessee the right to renew its lease in order to ensure the continuation of his business and to secure his clients. French rules relating to commercial leases are very strict and it has to be ensured in a real-estate-related business combination that all the requirements are respected in the lease agreements. The minimum term of a commercial lease agreement is nine years. However, the parties can provide for a longer term. Unless otherwise agreed, the tenant may terminate the lease at the end of each three-year period by giving at least a six months' prior notice. The parties can provide for a longer term (such as a lease with a 12-year term). The lease agreement shall be prepared as a notarial deed if its term exceeds 12 years. In such a case, the lease shall be registered with the Land Register and is subject to the payment of registration duties.

A tenancy schedule notably indicating the rent level and break options, is part of the representations and warranties of a seller. Representations may cover ancillary costs that have wrongly been charged to the tenant. As strict case law limits the restrictions of the legal indexation of the rent, issues are frequently to be found in such indexation clauses, therefore frequently discussed with the seller with regards to the representations and warranties.

23 Describe the legal due diligence required in the context of a real-estate-related business combination. What specialists are typically involved and at what point in the transaction are the various teams typically brought in?

Before issuing a firm offer letter, the purchaser will usually carry out extensive due diligence on the real estate asset or the target company. The legal due diligence (review of titles, zoning searches, review of building authorisations, review of leases, corporate and tax aspects, etc) will be conducted by notaries and lawyers, it being specified that the notary will review the title to property over 30 years, deeds creating easements, legal compliance with obligatory documents (asbestos, termites, legionella, energy performance report).

Technical and environmental surveys of the real estate asset will also be carried out.

24 How are title, lien, bankruptcy, litigation and tax searches typically conducted? On what levels are these searches typically run? What protection from bad title is available to buyers, and does this depend on the nature of the underlying asset?

Searches are conducted in the framework of a virtual data room where the whole documentation concerning the transaction is made available to the bidders.

All documents relating to the ownership of a property are published at the Land Registry. Notaries are therefore able to verify title to property over 30 years, easements, etc, by conducting additional searches. No transaction will occur if the notary is not in a position establish title to property over a 30-year period. No legal opinion or insurance will give protection against bad title.

A commercial court will provide a bankruptcy certificate or certificates regarding encumbrances and liens over the company or the business.

25 What are some of the primary lease issues and other agreements that the legal teams customarily review in the context of a real-estate-related business combination, and does the scope vary with the structure of the transaction?

The main lease issues are those mentioned in question 22 (ie, term of the leases, break options, rent level, indexation clauses), and legal focus generally remains on the lease situation.

The responsibility to review the title deeds in France lies with the notary public. Even in a share deal, it is common practice to involve a notary in this regard.

As broker fees are usually borne by the seller, such agreements are not analysed in acquisition due diligence.

Ancillary agreements (ie, all other agreements linked to the real estate such as maintenance agreements) are reviewed during the due diligence phase, in order to determine their conditions and whether it is interesting for a purchaser to pursue them.

In addition to real estate issues, in share deals, other important aspects have to be considered (management of past liabilities, calculation of purchase price).

26 What are the typical remedies for breach of a contract in the context of a real-estate-related business combination, and do they vary with the ownership of target or the structure of the transaction?

Remedies depend on the nature of the purchase agreement and the moment of the breach. In most cases, there are two options:

- to consider that the contract still need to be executed. Therefore, a party has the right to enforce the execution of the purchase agreement against the other party in breach; or
- to consider that the contract is terminated with the possibility to claim for damages (around 10 per cent of the purchase price).

27 How does a buyer typically finance real-estate-related business combinations?

A real estate asset is typically financed by a mix of equity and indebtedness.

The level of equity and debt in real estate assets' financing depends in particular on the bank indebtedness' conditions (which will take into account the property's use, its location, its vacancy and the quality of the borrower). Bank policy also usually requires the level of indebtedness not to exceed 50 per cent of the value of the real asset (much lower than before the subprime crisis).

Investors have also undertaken major fundraising during recent years in the real-estate-asset sector and have to invest their equity. This will impact the level of equity injected.

If it is at the property level, the bank indebtedness will usually finance the property's acquisition price or works on the property. In a share deal, the purpose will be to refinance the existing indebtedness of the target company.

28 What are the typical obligations of the seller in the financing?

At the acquisition date, the real estate asset and its revenues (and the borrower's shares in case of senior line indebtedness) shall be clear from any privilege and the seller shall provide the purchaser with the relevant release agreement. The seller shall also provide the purchaser with all information usually required within the context of an acquisition of real estate asset, such information being communicated to the bank and its advisers. The seller shall also authorise the banks and the real estate expert to visit the property.

29 What repayment guarantees do lenders typically require in the context of a real-estate-related business combination? For what purposes are reserves usually required?

The following reserves are usually required by the banks:

- to cover any borrower's cash shortfall in the case of vacancy or rent-free periods;
- to cover a specific issue that shall be financed with equity or excess cash: capex costs, tenant improvements, repairs leasing or tax; and
- to cure a soft financial ratio.

In the case of default or breach of the financial ratio: upstream payments will be forbidden and any excess cash will be put into reserve (either transferred to a cash collateral account or retained to the operating account) or allocated to the repayment of the indebtedness.

30 What covenants do lenders usually insist on in the context of a real-estate-related business combination? Does this vary with the overall financing of the transaction?

Real estate financing documentation includes specific covenants with respect to the property: its maintenance, evidence that sufficient insurance policies have been subscribed, environmental covenants and no third-party claims (no easements other than usual or compulsory and in any case minor ones).

To provide the banks with information relating to the operation of the property (tenancy schedule, vacancy rate, occurrence of any damage or any litigation with tenants) on a regular basis is also crucial.

An independent real estate expert shall also perform a valuation of the property on a regular basis (usually every year).

Any voluntary modification of conditions regarding specific documents (such as lease or asset management agreement) may require the banks' prior approval.

LPA-CGR avocats

Frédérique Chaillou **fchaillou@lpalaw.com**
Raphaël Chantelot **rchantelot@lpalaw.com**
Florence Defradas **fdefradas@lpalaw.com**
François-Régis Fabre-Falret **ffabre-falret@lpalaw.com**
Sandra Fernandes **sfernandes@lpalaw.com**
Silke Nadolni **snadolni@lpalaw.com**
Chloé Thiéblemont **cthieblemont@lpalaw.com**

136 avenue des Champs-Elysées
75008 Paris
France

Tel: +33 1 53 93 30 00
Fax: +33 1 53 93 30 30
www.lpalaw.com

As regards financial ratios the documentation systematically includes:

- the loan to value ratio, which checks that the loan does not exceed a certain percentage of the property's value; and
- the interest coverage ratio (ICR ratio), which checks that the revenues generated by the property are sufficient to cover the debt service (without taking into account amortisation of the facility); and the operating costs or the debt service ratio, which have the same purpose as the ICR ratio and includes amortisation of the facility.

If the real estate transaction is financed with a corporate line facility (in which case no mortgage is required), the covenants relating to the property are lighter.

31 What equity financing provisions are common in a going-private real-estate-related transaction? Does it depend on the structure of the buyer?

Financing documentation imposes strict control on upstream payment and some compulsory equity injection requirements.

Upstream payments shall be subordinated to the debt, limited to the excess cash available to the borrower and cannot occur if a default (or a breach of financial ratio) has occurred and is continuing.

Equity injection provisions may be required to cure a covenant (financial ratios, repayment obligations) or to solve a specific issue (works financing, etc).

32 Are there particular legal considerations that shape the formation and activities of REITs?

A REIT can only run activities listed by law that consist of the acquisition of real estate assets (buildings, financial leases on buildings, and shares in real-estate-oriented companies) with a view to rent them. The investment must be of a long-term investment. A REIT cannot run a commercial activity.

33 Are there particular legal considerations that shape the formation and activities of real-estate-focused private equity funds? Does this vary depending on the target assets or investors?

As regards formation, legal considerations will depend on the type of investors and, for instance:

- whether they are foreign or domestics investors or even a mix; and
- whether they are regulated or not.

Some activities are regulated and the capacity to invoice fees needs, in some cases, to receive prior approval from the French authorities such as the AMF. Some activities must be duly registered, and some specific legal requirements apply, such as for the managing of a real estate asset (that requires a property manager).

Getting the Deal Through

Acquisition Finance
Advertising & Marketing
Agribusiness
Air Transport
Anti-Corruption Regulation
Anti-Money Laundering
Appeals
Arbitration
Asset Recovery
Automotive
Aviation Finance & Leasing
Aviation Liability
Banking Regulation
Cartel Regulation
Class Actions
Cloud Computing
Commercial Contracts
Competition Compliance
Complex Commercial Litigation
Construction
Copyright
Corporate Governance
Corporate Immigration
Cybersecurity
Data Protection & Privacy
Debt Capital Markets
Dispute Resolution
Distribution & Agency
Domains & Domain Names
Dominance
e-Commerce
Electricity Regulation
Energy Disputes
Enforcement of Foreign Judgments
Environment & Climate Regulation
Equity Derivatives
Executive Compensation & Employee Benefits
Financial Services Litigation
Fintech
Foreign Investment Review
Franchise
Fund Management
Gas Regulation
Government Investigations
Healthcare Enforcement & Litigation
High-Yield Debt
Initial Public Offerings
Insurance & Reinsurance
Insurance Litigation
Intellectual Property & Antitrust
Investment Treaty Arbitration
Islamic Finance & Markets
Labour & Employment
Legal Privilege & Professional Secrecy
Licensing
Life Sciences
Loans & Secured Financing
Mediation
Merger Control
Mergers & Acquisitions
Mining
Oil Regulation
Outsourcing
Patents
Pensions & Retirement Plans
Pharmaceutical Antitrust
Ports & Terminals
Private Antitrust Litigation
Private Banking & Wealth Management
Private Client
Private Equity
Private M&A
Product Liability
Product Recall
Project Finance
Public-Private Partnerships
Public Procurement
Real Estate
Real Estate M&A
Renewable Energy
Restructuring & Insolvency
Right of Publicity
Risk & Compliance Management
Securities Finance
Securities Litigation
Shareholder Activism & Engagement
Ship Finance
Shipbuilding
Shipping
State Aid
Structured Finance & Securitisation
Tax Controversy
Tax on Inbound Investment
Telecoms & Media
Trade & Customs
Trademarks
Transfer Pricing
Vertical Agreements

Also available digitally

Online

www.gettingthedealthrough.com

Law Business Research

Real Estate M&A
ISSN 2514-4839

THE QUEEN'S AWARDS FOR ENTERPRISE: 2012

LACCA
LATIN AMERICAN CORPORATE COUNSEL ASSOCIATION

Official Partner of the Latin American Corporate Counsel Association

ABA Section of International Law
Your Gateway to International Practice

Strategic Research Sponsor of the ABA Section of International Law