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New Regulatory Status for Belgian Real Estate Investment Trust (*SICAFI/VASTGOEDBEVAKS*)

After lengthy negotiations amongst the various actors of the real estate and financial sectors, a new Royal Decree of 7 December 2010 on Real Estate Investment Trusts ("*sicafi*" / "*vastgoed-bevaks*") was published on 28 December 2010 (the **Royal Decree**). The Royal Decree considerably modifies the regulatory regime applicable to Belgian REIT by repealing and replacing both the Royal Decree of 10 April 1995 and the Royal Decree of 21 June 2006 which contained respectively the regulatory and accounting regimes formerly applicable to Belgian REIT. Both regimes are now encompassed in this new single piece of regulation which implements the Law of 20 July 2004 on collective investment undertakings. This *DechertOnPoint* briefly examines the main changes contained in this new regulation.

Introduction

The Royal Decree aims at (i) encompassing various recent changes in the legislation regarding collective investment undertakings, public offerings, obligations of issuers on regulated markets and the EU rules on the application of international accounting standards as well as (ii) improving and thoroughly modernizing the legal regime applicable to Belgian REIT by bringing in certain important changes that are summarized below.[1]

New Form of REIT: The Institutional REIT

The Royal Decree creates a distinction between the public REIT ("*sicafi publique*" / "*openbare vastgoedbevak*"), i.e. the "classic" listed collective investment undertaking, and the new institutional REIT ("*sicafi institutionnelle*" / "*institutionele vastgoedbevak*") which can now be created and used by a public REIT as a special vehicle for the realization of specific projects with institutional investors (such as public entities, credit or financial institutions, investment firms, collective investment undertakings, insurance companies, etc) and which should facilitate the participation of REIT to public-private partnerships.

A public REIT can only hold, either directly or indirectly, shares in an institutional REIT (or in a real estate company), if it has the exclusive or joint control over the acquired entity. Furthermore, a public REIT is not allowed to jointly control an institutional REIT (or a real estate company) together with another public REIT unless both are under the control of the same public REIT.[2]

These requirements, which aim at ensuring that the public REIT is always collectively managed in the exclusive interest of its shareholders, are a prerequisite in order for the shares (in an institutional REIT or real estate company) to be considered as a "real estate asset" ("*bien immobilier*" / "*vastgoed*") within the meaning of the Royal Decree.

1 Public REIT and statutory managers (SA/NV) of REIT having adopted the form of a SCA / Comm. VA must adapt their articles of association to the new provisions of the Royal Decree within 18 months from the entry into force of the Royal Decree.

2 Different rules apply to institutional REIT depending on whether they are exclusively or jointly controlled by a public REIT (additional guarantees are provided in the latter case).

New Rules on Capital Increase

Under the former Royal Decree, a REIT was prohibited from cancelling or limiting the preferential subscription right of the existing shareholders when increasing its share capital and was therefore compelled to comply with the mandatory minimum subscription period of 15 days when wishing to access the capital markets (Article 593 of the Companies Code).

One of the most important changes introduced by the Royal Decree is the possibility for a public REIT to increase its share capital against a contribution in cash with cancellation or limitation of the preferential subscription rights provided that a priority allocation right ("*droit d'allocation irréductible*" / "*onherleidbaar toewijzingsrecht*") is granted to the existing shareholders.[3] Such priority allocation right (which aims at replicating the economical effect of a statutory preferential subscription right) is subject to certain requirements:[4]

- it must concern all newly issued securities (it is therefore not possible to divide the offering into free and reserved tranches);
- it is granted to the shareholders in proportion to their shareholding;
- a maximum price per share must be announced at the latest the day before the opening of the subscription period;
- a minimum subscription period of three listing days is required.[5]

The shortening of the subscription period (three days versus 15 days previously) should facilitate the access of public REIT to the capital markets to finance their investment needs. It should indeed allow public REIT to be less exposed to the volatility of the market and banks (lead managers) should therefore be less inclined to recommend important discounts which are detrimental to the REIT's image and to the shareholder who has not exercised his/her preferential right (dilution).

Additional requirements are also introduced in the event of a capital increase against a contribution in kind.[6]

Finally, where an institutional REIT controlled by a public REIT decides to increase its share capital in cash at a discount of more than 10%, certain information requirements apply towards the shareholders of the public REIT (such as the drafting of a special report by the management body of the public REIT).

Debt Ratio

The public REIT is still subject to the following limits:[7]

- the debt ratio of the public REIT may not exceed 65 % of its total assets;
- the annual financial charges relating to the consolidated debt of the public REIT may not exceed 80% of the amount of its revenues and charges increased with the amount of its financial products.

The Royal Decree now provides that the 65% threshold must be complied with at two different levels, i.e. at statutory level (at the level of the relevant public REIT) and at consolidated level (at the level of the group).[8] This double threshold must be appreciated at the time of the subscription of a new debt and shall therefore not apply where the threshold is exceeded due to a variation of the fair value of the public REIT's assets.

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3 Such possibility must be provided for in the articles of association of the public REIT. The articles of association may also provide an exception to the granting of a priority allocation right in case of a contribution in cash with limitation or cancellation of preferential rights supplementary to a contribution in kind within the framework of the distribution of an optional dividend provided such optional dividend is open to all shareholders.

4 These specific requirements are without prejudice to the application of articles 595 to 599 of the Companies Code.

5 A shorter subscription period is always possible for institutional investors in accordance with article 3 of the Royal Decree of 17 May 2007 on primary market practices. There is no obligation for the priority allocation right to be listed.

6 The Royal Decree imposes new criteria for determining the minimum issue price, additional mentions to be made in the special report of the management body drawn up in accordance with article 602 of the Companies Code, etc. These rules apply *mutatis mutandis* to mergers, demergers and assimilated operations.

7 The same limits and percentage were already applicable under the former Royal Decree.

8 Under the former regime, the debt ratio was always calculated on a consolidated basis. A one-year transitional period is provided to allow public REIT that are in breach of the 65% statutory threshold to restructure their debt accordingly.

The Royal Decree also provides for the following important new rules:

- if and where the debt percentage exceeds 50% of the consolidated assets, the REIT is now compelled to draft a financial plan together with a time schedule describing the measures that the REIT proposes to take in order to avoid exceeding the general threshold of 65% in the future. A special report must also be drawn up by the statutory auditor confirming the consistency of such plan with the accounting record of the public REIT; [9]

- if the consolidated debt ratio or statutory debt ratio remains in excess of the 65% threshold for more than two years from the date the REIT has become aware of such breach, the general meeting of shareholders must be convened within three months in order to decide on the possible dissolution of the REIT or on other measures to remedy such breach.

Distribution of Profits

As was already the case under the former Royal Decree, a public REIT must distribute 80% of its net profits to its shareholders.[10] The Royal Decree now provides that no distribution is permitted if the statutory or consolidated debt ratio of the public REIT already exceeds 65% or if such distribution has the effect of increasing the global debt ratio of the REIT above the 65% threshold.[11] Undistributed profits (that should have been distributed pursuant to the 80% rule but were not distributed because of the 65% threshold) shall be allocated to the reserve and be used only in view of decreasing the consolidated or statutory debt ratio (as the case may be) below the 65% threshold.

Investment Diversification

A public REIT is still prohibited from investing more than 20% of its assets (on a consolidated basis) in "one single real estate entity" ("*un seul ensemble immobilier*" / "*een enkel vastgoedgeheel*") i.e., one or several real estate which are to be considered as one single investment risk for the public REIT, such limit being appreciated at the time of the real estate acquisition by the REIT.[12]

Specific derogations to this rule may be granted by the CBFA[13] which can now appoint one or several experts (to be remunerated by the REIT) to assess whether the relevant real estate forms one single real estate entity within the meaning of the Royal Decree and/or to assist the CBFA for the purpose of granting the derogation.

Where the REIT does not comply with the investment diversification requirements (set out in the Royal Decree or in its articles of association) or is in breach of the conditions imposed in the derogation granted by the CBFA, the general meeting of shareholders must be convened within three months of becoming aware of such breach in order to decide on the possible dissolution of the REIT or on other measures to remedy such breach.

Shareholdings in Other Companies

The Royal Decree contains further limitations regarding the acquisition by a public REIT of participation in other companies. As already mentioned, a public REIT can only hold, either directly or indirectly, shares in an institutional REIT or in a real estate company, if it has the exclusive or joint control over the acquired entity. Furthermore, when a public REIT exclusively controls other companies without holding, either directly or indirectly, the entirety of their share capital, certain strict requirements must be complied with.[14]

In addition to these requirements, when a public REIT jointly controls another company together with a third party, the articles of association of such company (or any other relevant document) must provide—in order to address a possible conflict between shareholders which affects the management of the controlled company— the right for the public REIT to either acquire from (call option) or sell its stake to (put option) the other shareholder(s)

9 The business plan and the special report are communicated to the CBFA for information purposes.

10 The public REIT must distribute an amount equal to the positive difference between 80% of its net profits (calculated in accordance with the relevant provision and schema contained in the Royal Decree) and the net decrease of its debt during the past financial year.

11 A one-year transitional period is provided to allow public REIT that are in breach of the 65% statutory threshold to distribute dividends during such period (and to remedy the breach).

12 This limit shall therefore not apply where the threshold is exceeded due to a variation of the fair value of the REIT's assets.

13 Such possibility already existed under the former Royal Decree.

14 See the various shareholding requirements (and percentages) contained in article 42 of the Royal Decree.

with whom a conflict exists (purchase price to be determined by independent experts).

Real Estate Experts

Independence criteria of real estate experts (responsible for the valuation of the real estate portfolio of the public REIT and its subsidiaries)[15] have been reinforced in order to prevent potential conflicts of interest:[16]

- the expert shall not be linked to or have a participation in the promoter, nor can the expert perform any management duties and/or have any other link or relationship with the promoter that can impede his independence;
- he/it should have the necessary reputation and appropriate experience to perform real estate valuation and his organization must comply with the activity of expert;
- his/its remuneration cannot be, either directly or indirectly, linked to the value of real estate assets being appraised;[17]

The expert is appointed for a term of three years renewable and can only be in charge of the valuation of a specific real estate asset during a period of maximum three years. After such term, a three-year cooling off period must be complied with before the same expert can appraise the same real estate asset again.[18]

Additional Changes

A series of other new rules have been introduced by the Royal Decree.

Possibility to Issue Securities Other than Shares

The Royal Decree now expressly provides the possibility for a public REIT to issue securities other than shares (such as bonds) although securities which do not represent the share capital, such as profit-sharing certificates ("*parts beneficiaires*" / "*winstbewijzen*") or similar securities are expressly excluded.

Role and Obligations of the Promoter of the Public REIT

The Royal Decree modifies the definition and notion of "promoter" ("*promoteur*" / "*promotor*") of a public REIT.[19] Are considered promoters, the persons controlling exclusively or jointly the public REIT or the persons controlling the manager (legal person) of the public REIT that has adopted the form of a partnership limited by shares ("*SCA*" / "*Comm. VA*").[20]

The promoter's best efforts obligation to have at least 30% of the share capital of the public REIT held by the public has now become a continuous and permanent obligation. The promoter must at any time take all reasonable measures in order to reach such threshold.

Granting of Credit, Security and Guarantee

The granting of credit, security (mortgage, etc.) or guarantee by a public REIT or by its subsidiaries is now only permitted (i) within the group (hence no credit or security can be granted to or on behalf of a third party) and (ii) within the framework of the financing of the real estate activities of the public REIT or of its group.

The granting of security and guarantee (within the above limits) can now represent up to 50% of the global fair value of the portfolio of the public REIT on a consolidated basis (instead of 40% under the former Royal Decree).[21]

Governance and Organization

The Royal Decree provides for the following new rules:

- The board of directors of the public REIT must now be composed of at least three independent directors (within the meaning of

15 Since the expert is responsible for the valuation of the real estate portfolio of the whole group, it is not mandatory for an institutional REIT to appoint a real estate expert.

16 A transitional period is provided to allow public REIT to comply with these new requirements.

17 This rule does not prohibit that the remuneration of the expert be based on an objective criterion such as the surface area of the appraised assets.

18 If the expert is a company, these rules only apply to its representatives (individuals) provided that the expert can demonstrate an adequate functional independence between them.

19 An institutional REIT is not required to appoint a promoter.

20 The persons acquiring the control of the public REIT during the life of the REIT are also considered promoters.

21 The mortgage, security or guarantee granted in connection with a specific real estate asset may not exceed 75% of the value of such asset (same rule as before).

article 526ter of the Belgian Companies Code);[22]

- In order to avoid that organizational rules be without effect where the REIT has adopted the form of a SCA / Comm. VA, certain rules have been made applicable to the statutory manager ("*commandité*" / "*beherende vennoot*") of the public REIT and to the management body of such manager;[23]

- The possibility has been introduced for a public REIT to delegate the management of its (consolidated) real estate portfolio to a company controlled by the public REIT which specializes in real estate management;

- It is no longer mandatory for a public REIT to appoint a custodian ("*dépositaire*" / "*bewaarder*");[24]

- It is no longer required to obtain the prior approval of the CBFA regarding the amount of fees, commissions and costs that will be incurred by the public REIT;[25]

- The scope of the conflict of interest rules has been broadened and adapted to take into account the creation of the new institutional REIT.

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22 A transitional period allows independent directors appointed before 8 January 2009 (and who fulfill the independence criteria applicable before the entry into force of new article 526ter of the Companies Code) to sit on the board of directors of the public REIT until 1 July 2011.

23 The SCA / Comm. VA is usually managed by a public limited company (SA / NV), acting through its board of directors, which is solely responsible for the management of the REIT.

24 The public REIT must still appoint a "person entrusted with the financial service" ("*personne chargée du service financier*" / "*persoon belast met de financiële dienst*"), i.e. a financial institution in charge of the distribution of the dividends, the settlement and delivery of securities issued by the public REIT and of the collection of information to be published by the REIT. Such person is not involved in real estate transaction and its mission is therefore more limited than the mission of the custodian bank under the former Royal Decree.

25 The fixed or variable remuneration of the managers/directors may not be linked to the operations performed by the public REIT and its subsidiaries.

Practice group contacts

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