



July 2016

Leaving the EU: the legal implications for commercial real estate

Following the UK's referendum vote in favour of leaving the EU and the appointment of Theresa May as prime minister, this briefing considers the key legal implications for the commercial real estate sector.

Commercial impact

Brexit does not represent the same disaster as the post-Lehman shock where capital and bank debt dried up and deal flow ground to a halt. Commentators are not expecting that to happen and there are clearly cash rich investors in the market looking for bargains should they become available. That said, activity levels in the commercial property sector had already declined before the referendum and the expectation is that this will continue over the next couple of months. Beyond that, the position is unclear and there is speculation as to what will happen to tenant demand, values, fund activity and bank appetite for deals.

Impact on real estate law

Most law affecting commercial real estate in the UK is not driven by EU legislation and will not be affected by Brexit. The legal systems for real estate in England/Wales, Scotland and Northern Ireland are different to each other and independent, although they have many features in common. There is no reason to expect fundamental change.

There are some laws which have been required or influenced by membership of the EU. This includes, for example, some environmental and health and safety legislation. These laws will not automatically end on Brexit but we may see the Government using Brexit as an opportunity to change some of them.

There are other laws which may affect the way that the real estate sector operates, including financial services regulation and employment law, which will be more directly affected.

Legally, has anything changed yet?

Despite the vote to leave, the UK's membership of the EU continues until it has formally withdrawn. Negotiation of a "**Withdrawal Treaty**" or "**WT**" is likely to take some time – probably several years. It follows that businesses will have time to prepare for the impact of Brexit, including the legal ramifications.

EU Treaties will cease to apply to the UK on the expiry of a period of **2 years** (or longer if agreed with the remaining EU countries "**rEU**") from the date the UK formally notifies the EU of its decision

to leave (or the date on which a WT is concluded, if earlier).

What needs to be agreed with the rEU?

Amongst the many issues that the UK will need to broker with rEU:

- ideally a free trade agreement, including provision for the export of services (a large proportion of the UK's exports to the EU);
- wide-ranging implications for UK-based financial services firms, on which we have prepared a [separate briefing](#);
- the status of UK citizens living in other EU member states;
- the status of EU workers in the UK, on which our employment team have prepared a [further briefing](#); and
- whether certain pieces of EU legislation should continue to apply to the UK post-exit (e.g. recent EU legislation abolishing mobile phone roaming charges).



Negotiations on some of these issues are likely to be complex and may make it difficult to conclude a genuinely comprehensive UK-EU settlement by 2020, as envisaged by Vote Leave.

How would national law be changed?

In our view, it is unlikely to be possible to review all affected legislation by 2020, as this will be a very time-consuming and onerous task. It is probable that some EU-derived legislation will have to be retained as part of UK law beyond that date – and the process of reviewing it is likely to continue for some years after Brexit.

KEY POINTS FOR BUSINESS

- From a purely legal perspective, **nothing will change immediately** and businesses are likely to have some time in which to prepare for Brexit.
- Looking at the longer term, businesses should start to plan for likely legal changes to follow Brexit.
- From a commercial perspective, uncertainty and market volatility is already having an effect.
- However, premium UK real estate will remain very attractive to investors.

KEY COMMERCIAL POINTS

Open Ended Funds – are they open for business?

10 large open ended real estate funds worth £18 billion suspended redemptions post referendum. Commentators have queried whether this is appropriate, whether it reflects underlying problems with those funds or with the market, and whether the Financial Conduct Authority ("FCA") should regulate open ended funds more heavily.

Fund documentation typically permits the temporary suspension of issue, sale and redemption of units in exceptional circumstances, where it is thought to be in the interests of all the unit holders to do so. The suspension must be kept under periodic review.

If a substantial number of unit holders wish to have their cash paid back immediately, it is difficult to value the units, particularly in an uncertain market, and there will be pressure on the manager to sell the most easily realisable assets in the fund, perhaps at a discount. Such a course of action may well prejudice remaining unit holders.

It is arguable that suspension is a perfectly sensible, healthy approach that protects value, preserves the balance of equality between unit holders who want to leave and those who want to remain, and lends stability to the market. The key question is perhaps not whether more FCA regulation is required, but whether retail investors

who invest in these funds understand the nature of the investment they are buying.

Protection of the environment – a bonfire of restrictions and carbon targets?

Before the Westminster soap opera had fully unfolded (if indeed it now has), commentators felt broadly that the climate change levy and proposed Minimum Energy Efficiency Standards were unlikely to change in the event of Brexit. As early indications from the newly formed government are that climate change does not lead the agenda – merging DECC with BIS to form the Department for Business, Energy and Industrial Strategy ("DBEIS") being one clue - that view may have to be revised. The UK has its own legally-binding emissions reduction targets through the Climate Change Act 2008. It has international obligations, pursuant to the UN Framework Convention on Climate Change. It also has EU driven commitments such as the Renewable Energy Directive, EU Emissions Trading System and the recent Paris Agreement.

The message from DBEIS is that the reduction of carbon emission must not jeopardise economic growth. Looking into the crystal ball, then, it seems unlikely that the UK will be honouring all of its environmental commitments but Brexit may, in this as in other areas, represent an opportunity to devise a more UK-focused environmental regime.

EU employees and contractors – will they be sent home?

Theresa May has been criticised for refusing to guarantee the rights of EU nationals living in the UK to continue to live and work here. While there is no indication that these rights will be affected in the short term, the longer term picture remains unclear. So what should employers be doing now?

Many employers are auditing the number of EU nationals that currently work for them.

While some employers are communicating with staff offering reassurance that nothing is changing in the short term, employers must be careful not to offer any guarantees while the legal position remain uncertain.

The construction industry relies heavily on EU nationals, and while lack of available labour would be principally a risk for the contractor, it is an issue to which developers should also be alive.

Interest rate floors – will borrowers enjoy negative interest rates?

UK base rates have been at 0.5% since March 2009. Up until the referendum, the expectation has been that the direction of the next move in rates will be upwards. Most commercial property loans and hedging are linked directly or indirectly to LIBOR. It has become common, although not standard, practice within the last few years for banks to put a floor on LIBOR (often 0%) for the purposes of establishing the interest rate on a loan. If rates fall below zero, as has now been seen in a number of other western economies, the borrower will not get the benefit of this.

Until very recently, borrowers were not particularly concerned, expecting rates to increase - and having other things to worry about. Whilst the Monetary Policy Committee held interest rates at 0.5% at the recent monthly meeting, it is expected that the next rate movement will be down. Some commentators have suggested that interest rate floors could be the next mis-selling scandal, on the basis that borrowers have been signing up to these provisions without really understanding the implications. Borrowers should be checking existing facilities and taking appropriate advice on any new facilities where an interest floor is proposed. We expect to see this become a more heavily negotiated issue.

An open market for selling investment funds – will I lose my passport?

Impact on cross border marketing and EU structures

Property funds which are marketed from the UK into the EU are typically marketed by UK firms authorised under EU financial services legislation. Firms will need to assess whether they can raise new funds from EU investors post-Brexit. This will depend on the terms of departure.

If the UK leaves the EU without a special deal and does not join the European Economic Area ("EEA"), it will become a "third country". This would mean the "passport" will fall away.

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Firms will then need to explore "reverse solicitation", national private placement regimes, "equivalence" status and/or using onshore EU service providers.

If the UK joins the EEA, the passport will remain for retail funds classified as "undertakings for collective investment in transferable securities" but may not apply to institutional funds classified as "alternative investment funds", as the EEA has not yet adopted the Alternative Investment Fund Managers Directive.

Firms with structures in other parts of the EU will also need to assess their ability to continue to run those structures following Brexit.

CONTACTS

For further information or advice on the legal implications of Brexit, please speak to your usual contact at the firm or any of the lawyers listed below.

10 Snow Hill
London EC1A 2AL
T: +44 (0)20 7295 3000
F: +44 (0)20 7295 3500
www.traverssmith.com



Anthony Judge

Partner, Head of Real Estate

E: anthony.judge@traverssmith.com
T: +44(0)20 72953237



Julian Bass

Partner

E: julian.bass@traverssmith.com
T: +44 (0)20 7295 3279



Simon Rutman

Partner

E: simon.rutman@traverssmith.com
T: +44(0)20 72953379



Paul Kenny

Partner

E: aul.kenny@traverssmith.com
T: +44 (0)20 7295 3385