



# International Real Estate Investment

Financing and structuring  
cross-border real estate  
transactions

Virtual Round Table Series  
Real Estate Working Group 2017

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## Financing and structuring cross-border real estate transactions

Real estate is big business globally as buyers increasingly look beyond their own borders for lucrative investments.

Research by property broker Tranio suggests that USD 426.8 billion was invested in cross-border real estate transactions in 2016, with commercial property attracting deals worth USD188.4 billion, while USD238.4 billion was spent on overseas residential property. The US saw the largest volume of cross-border real estate deals with foreign nationals spending USD149 billion.

While these types of international deals are becoming commonplace, there is still much to consider for investors targeting foreign property. They must understand how real estate finance works in their jurisdiction of choice, including regulations, availability of capital and accepted structures.

They must also be willing to carry out extensive due diligence before risking their capital, taking time to understand all the peculiarities of a jurisdiction that might impact investment decisions. Once a foreign buyer is ready to invest they should also consider the tax implications of owning assets and generating income in a foreign country, structuring their investment vehicles in the most efficient fashion.

Having an expert on the ground with intimate knowledge of the investment location is essential to a smooth purchase process. With this in mind IR Global brought together six members of its Real Estate Group to discuss cross-border real estate transactions.

The aim of the feature is to give members and their clients valuable insight into the real estate transaction process across a range of jurisdictions, including best practice approaches and advice.

The following discussion involves IR Global members from Germany, the USA - California and New York, Canada and Belgium



## The View from IR

**Ross Nicholls**

**BUSINESS DEVELOPMENT DIRECTOR**

Our Virtual Series publications bring together a number of the network's members to discuss a different practice area-related topic. The participants share their expertise and offer a unique perspective from the jurisdiction they operate in.

This initiative highlights the emphasis we place on collaboration within the IR Global community and the need for effective knowledge sharing.

Each discussion features just one representative per jurisdiction, with the subject matter chosen by the steering committee of the relevant working group. The goal is to provide insight into challenges and opportunities identified by specialist practitioners.

We firmly believe the power of a global network comes from sharing ideas and expertise, enabling our members to better serve their clients' international needs.



GERMANY

## Dr. Peter Diedrich

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Dr. Peter Diedrich is the Managing Partner of DSC Legal and specialises in advising national and international clients in nearly all aspects of real estate investments in Germany.

For more than 20 years, he has been advising clients in real property acquisitions, investments and financing. Peter also has experience and expertise in mergers and acquisitions, corporate law, and international arbitration. He is a double qualified lawyer with admission in Germany and Poland and appointed as notary public in Berlin.

After having successfully completed his parent house apprenticeship at Siemens, Peter studied law at Freie Universität Berlin and passed his bar exam in Berlin in 1989. From 1989 until 2010, Peter worked as an attorney-at-law and partner at firms including Gaedertz, Haarmann Hemmelrath, Ernst & Young and Olswang.

In 1994, Peter received his doctor's degree from the Faculty of Law of Freie Universität Berlin. In 1997, Peter was officially appointed as a notary in Berlin. He is also admitted to the Polish Bar (Adwokat).



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Dieter spent 14 years with international law firm Loyens & Loeff, advising Belgian and foreign businesses in the areas of financing, restructuring, debt structuring and regulatory advice, before joining Astrea as a partner in 2014.

He now specialises in start-up and venture capital, capital markets and securities law and financial and banking law. He holds a Master in Law from the University of Leuven and a Master of Business Law from the University of Antwerp.

Dieter is admitted to the Brussels Bar and is an active member of AIJA and the IBA. He is recommended in his field by IFLR 1000, Legal 500 and Chambers Global.

He speaks Dutch, English, German and French.



US - NEW YORK

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Michael Lefkowitz specialises in representing clients in commercial real estate transactions throughout the US with a concentration on deals in New York City. For years he has been representing lenders and borrowers in completing complex financing transactions and also in the workout of troubled loans. Since joining Rosenberg & Estis, he has greatly expanded the firm's expertise in the representation of private commercial lenders in making first mortgage and mezzanine loans, as well as lender to lender participations and note financings. Michael has a national practice representing lenders, sponsors and equity investors in the purchasing, sale, financing and leasing of real estate in all types of asset classes.

His broad skill set provides him with the knowledge of the numbers behind a deal, the real value of a project, and whether a transaction truly makes sense.



US - NEW YORK

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Richard Sussman is known for his breadth of knowledge and experience which have solidified his status as a skillful and highly valued practitioner at Rosenberg & Estis, P.C. For Richard, the goal is creativity, creating solutions to complex problems toward the goal of achieving the objectives of his clients.

Richard has had no shortage of opportunities to engage in creative solutions. His wide-ranging and sophisticated practice encompasses all phases of real estate transactions in both New York City and elsewhere.

Richard's client base is unusually broad. He represents everyone from individual and institutional developers, owners and lenders to syndicators, investors and brokers. He has structured and negotiated complex transactions involving multi-family buildings and complexes, office buildings, shopping centres, hotels, air and development rights, development parcels and mixed-use facilities. The nature of the transactions on which Richard has worked is also diverse, including purchases and sales, partnerships and joint ventures, workouts, and complex leasing and financing.



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Bob Blanchard has more than thirty years of experience in real estate and corporate finance. His areas of practice include complex real estate acquisitions, dispositions and exchanges, corporate mergers and acquisitions, asset and mortgage securitisation, business and real estate lending, tax credit financing, and the regulation of financial institutions and securities markets.

Prior to founding Blanchard, Krasner & French in La Jolla, California, Bob was partner in the Los Angeles law firm of Sheppard, Mullin, Richter & Hampton and prior to that, a partner in the law firm of Seltzer, Caplan, Wilkins and McMahon based in San Diego.

Bob is widely published and a frequent speaker on numerous topics, including speaking on "The Evolving Worldwide Legal and Regulatory Climate for Securitization" at a meeting of the American Bar Association held in Brussels, Belgium, and contributing author of Commercial Real Estate Finance: A Current Guide to Representing Lenders and Borrowers, ABA.



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Jayson Schwarz is the founder and senior partner of Schwarz Law LLP. In almost 40 years of practice he has acted for clients that are multi-national corporations and small and medium sized businesses. The bulk of his practice is devoted to solving puzzles. Whether it is organising a land acquisition and the necessary financing or assisting in a complex estate planning scenario, Jayson excels in out of the box solutions and creative thinking, that lead to economic success, tax savings and personally satisfying the needs of his clients.

Experience in the real estate industry on a personal level is bolstered by his close relationships with many of the largest builders and land developers in Ontario. Jayson has been a member of BILD (the "Building and Land Development Association") for many years; has lectured for the Ontario Government Tarion Warranty Program to new homebuyers; is the resident real estate legal writer for numerous magazines with many published articles and is often asked to quote by national publications, and television on real estate matters.

Under his aegis the firm has involved in many international commercial transactions involving various American, Caribbean, South American, African and European jurisdictions.

## QUESTION 1

# What are some of the popular financing/refinancing structures in your jurisdiction, particularly where foreign buyers are concerned?

**Germany –Dr. Peter Diedrich (PD)** Here in Germany you find mortgage-backed loans are the most typical financing method for 50 per cent of developments and as much as 100 per cent of deals for existing buildings.

There are a variety of other players offering senior or junior debt other than banks. Insurance companies are struggling to achieve sufficient yields, so they are very interested in real estate finance. Bond finance is also available, with plenty of players offering bond issuing services.

There are also mezzanine structures present in the market, and we have seen joint ventures design investment in this way. Investors from abroad find themselves subject to taxation in Germany as joint venture partners, so they are putting money into real estate projects and restructuring on an equity level.

Banks are struggling in Germany as there is negative interest for savings and lots of equity in the market looking for property investments. As a result, those banks have become very aggressive in attempting to get their projects positioned, offering higher leverage than once was the case. Leverage of up to 80-90 per cent is something borrowers can achieve.

There are almost no non-performing loans in the German real estate market, which is seen as a safe haven worldwide. You see money coming in from institutions and high net worth (HNW) individuals all over the world wanting to invest into the German property market, which is really experiencing an outstanding growth phase.

**Canada –Jayson Schwarz (JS)** From a financing perspective, all our banks and private funders require foreign buyers to put in between 40-50 per cent cash. With that, as long as the foreign buyer passes the good housekeeping rule, there is no difficulty arranging financing.

There are only three metro areas that are important in Canada, namely Vancouver, Montreal and Toronto. In Vancouver they are tremendously used to Asian buyers, so financing has regularised. Toronto has only just started to struggle, but as long as there is 40-50 per cent cash, most are able to do the deals.

Montreal is a civil law jurisdiction, but it has the same banks as the rest of the country so there is no problem with foreign buyers. The methodology and the structures being used are also important, usually a corporate acquisition, or a limited partnership if more than one entity is involved.

One thing to remember though, is that, in Ontario, they have just instituted a new land transfer tax regime, similar to stamp duty, where foreign buyers are penalised 15 per cent if not resident.

**New York –Richard Sussman (RS)** I think New York is somewhat comparable to Canada. We have a full range of banks as well as many private lenders. First mortgage debt is available, as is other debt which is used to reduce equity requirements. I think, for foreign buyers, the equity requirement might be slightly higher than for borrowers who are domestic, but again there are a lot of foreign banks with branches in New York. We often see foreign entities borrowing from banks they do business with at home, coordinated through the New York office.

**New York –Michael Lefkowitz (ML)** We represent a number of the private commercial lenders active in New York. I find that lots of foreign investors will use that as a source of financing, because they find that the major banking operations have 'know your customer' (KYC) requirements that are often cumbersome. It's not that they couldn't meet those requirements, but rather they can reduce the burden by using private commercial lenders.

Rates are higher, but the ease of transaction is a greater attraction than dealing with major institutions.



Dr. Peter Diedrich and Jayson Schwarz, pictured at the IR Dealmakers 2017 Conference in Barcelona.

**New York –RS** KYC is a Federal regulation imposed on banks by government. For banks, it is important to spread the risk and avoid putting all their eggs in one basket.

**New York –ML** New York has received a lot of foreign money through the EB-5 program. For USD500,000 somebody can obtain a green card to work or go to school in the US, as long as that is invested in a qualified real estate project.

Some of the largest construction deals in New York over the last four or five years have received a component of their financing from this EB-5 program. The future of the programme is currently being debated and they may alter it by imposing different requirements, although the consensus is that it will continue. It's a nationwide program, but a lot of the money is in New York.

**California –Robert Blanchard (RB)** Private finance, bank or collateralised mortgage-backed securities (CMBS) structures are what we are seeing most often. There is almost always a requirement for a special purpose vehicle (SPV) to hold the real property. For foreign investors, this is usually a corporation, largely for tax purposes.

In a recent transaction for non-US investors we had trusts in offshore jurisdictions as shareholders of the US ownership entity. The lender required KYC down to virtually every person with an interest in those trusts, including individual names.

Some of the foreign banks, directly or through their US subsidiaries, have also been active in the US market and sometimes seem easier to deal with. These include State Bank of India, which has provided our clients hotel financing, and East West Bank, Deutsche Bank AG and CBIC, which have financed commercial properties for both US investors and foreign investors.

**New York –ML** East West is big in New York as well.

**Belgium –Dieter Veestraeten (DV)** Belgium is different than Germany because we have a much smaller market. The most common type of financing or refinancing we see are mortgage-backed loans, which can be syndicated. Lenders are typically Belgian banks or international financial institutions (banks or insurance groups) from Germany, the US or the UK.

For most international transactions, the Loan Market Association (LMA) standards apply, adapted to Belgian law. We don't often see CMBS transactions; I have seen only one since 2007 and that attempt (in 2016) was aborted, with the loan sold to new lenders.

## QUESTION 2

# How important is due diligence and market place intelligence to a successful cross-border transaction in your jurisdiction? How can you assist clients to determine the best approach?

**Germany –PD** We mostly serve international investors and it is always important to run a proper due diligence process, especially for people from other countries and cultures. They must get as much information as possible in order to understand the legal environment.

We are used to running multi-disciplinary due diligence for our clients, doing the tax and legal due diligence ourselves and working closely with engineers running technical due diligence. We put all our findings together and pay attention to everything, drafting the SPA and highlighting issues for clients to be aware of. Quite often international banks financing German property investment request extra due diligence. Institutional clients usually require full due diligence, while family offices are often happy with a red flag due diligence.

Our clients are used to working together with multinational law firms under a four-week exclusivity period. What often happens is that, two days before deadline, they get a shocking report because they didn't get any updates throughout the process on the outcome.

We update our clients after every team meeting, keeping them informed on how the process is developing. The team here are driven by the idea that clients should be looked after properly.

**Canada –JS** Due diligence is critical, but in any deal you expect the client to have done their due diligence in terms of business issues. We can assist in our jurisdiction, pointing clients towards experts and helping them to complete the deal, but most people doing a cross-border transaction have a handle on what they are doing. If this is their first deal, we can advise on more research they may need to do and include that in our conditions on any acquisition.

If a client wants to enter another jurisdiction we have the capability, through IR Global, to provide them with information and contacts they can't get anywhere else. We are able to get clients answers on market or specific intelligence that ordinarily they couldn't get an answer for.

This is critical is at the front end. If Peter calls me and says he has a client in Berlin who wants to buy a hotel in Toronto, I can tell him where to go and who to talk to. That's invaluable.

**Belgium –DV** I fully agree that due diligence is extremely important, particularly when we act for foreign lenders who are not aware of local law issues such as legal title, existing collateral, lease agreements and break options.

Most lenders do not require lengthy due diligence reports, but prefer bullet point reports with a clear risk analysis, risk qualifiers and quantifiers and proposed remedies.

Our experience shows that a lot of issues spotted during due diligence, can be remedied during the process.

We have a specialised team to assist lenders in this respect.

**New York –RS** Due diligence is really critical in New York, particularly in residential property. We are a firm that is uniquely qualified in New York to assess the risk and advise clients on regulated rental housing.

Even if we are not representing clients on a specific transaction, they may come to us for advice on the regulatory and administrative aspects of what they are doing. There are also a lot of tax incentive programs in New York that can be taken advantage of, and we have people who advise on this for purchases and capital improvements.

**New York –ML** New York, unlike most jurisdictions, has a very complicated system of regulation around rental housing within the City itself; it also happens to be maybe the most competitive market in the USA. Rental apartment buildings trade for cap rates of 2 or 3 per cent just because of the high demand. Obviously the investors have an idea that they are going to figure out a way to work around the regulatory scheme in order to increase rent and cash flow for the property, but one misstep and a party can suffer significant fines and penalties for attempting to deregulate a unit.

On the commercial side, I am working on a project currently that involves the largest office building in Philadelphia, where we are representing the equity. There was already full due diligence on the property, but our client wanted a quick review of eight major leases in the building before investing USD125million. We were able to analyse these leases within a few days and abstract them for the client.

**Germany –PD** The strict regulation of rent on apartment buildings seen in New York also applies to Germany. There is a very strict policy on this issue now, because of a lack of residential places for tenants in big cities like Frankfurt, Dusseldorf, Munich and Berlin.

There are always attempts by investors to go around the rules, but, as lawyers, we advise clients on whether this rent they are charging is on risk, or still has upside between the contractual rent and regulatory ceilings. We advise on ways of overcoming the regulatory challenges so as to dramatically increase value and cash flow, for instance through energy-efficiency investments.

**California –RB** On the West Coast of the USA, all CMBS or commercial bank financing follows the same due diligence and underwriting rules. It is a very thorough process, but where we do see trouble is when foreign buyers pay cash and don't do the due diligence up front. When they try to get financing down the line, they run into issues.

There is also some misperception from buyers coming from outside the US on how title insurance works. They think that, because they have a title policy, all the issues are covered, but title policies have many exceptions and hidden risks. Covenants contained in them will often have restrictions such as zoning requirements or conditional use permits, or exceptions to title that only apply to that particular facility. If the improvements burn down, or existing use closes down, it doesn't mean you can rebuild or reopen the same thing at the same location.



Steven De Schrijver of Astrea, pictured at the 2016 Annual Conference in Amsterdam.



### QUESTION 3

## What are the tax implications for a foreign resident purchasing and/or selling property in your jurisdiction?

**Germany –PD** In Germany we must consider real estate transfer tax on one hand and income tax on the other. It's all about tax structuring via an efficient legal structure and we mostly assist international investors to consider real estate transfer tax issues on a case-by-case basis to determine the best ownership structure.

Germany has a speculation tax that requires a buyer to keep a property for more than 10 years before they can sell it tax free, no matter how big a profit they make. Transfer tax also plays a major role, as public bodies try to achieve more and more income. Several states in Germany charge a real estate transfer tax of up to 6.5 per cent per deal.

The bigger the deal, the more tax is due, and thus investors have more incentive in avoiding it. This is sometimes possible through a share-deal, depending on the legal form, which needs to be checked quite attentively. This involves a structure with two buyers, which takes advantage of the rule that states if one party is not acquiring more than 94 per cent of the company then there is no real estate transfer tax to be paid. The model brings a second buyer into the property deal with a 6 per cent stake.

**Canada –JS** On April 27th 2017, the Government of Ontario passed what is called a Non-Resident Speculation Tax. It applies to a non-resident corporation, or a Canadian corporation that has non-resident shareholders or beneficial owners.



Dr. Peter Diedrich, pictured at the 2017 'On the Road' Conference in Singapore.

It requires a large amount of due diligence, which has to be done by the lawyers. So, now, any non-resident purchasing property in the greater Toronto area faces an additional 15 per cent land transfer tax on the acquisition. There are exemptions, for example, if you have a child that goes to school here and you buy them a condo then, after two years, you get the tax back.

As a general rule the withholding tax is based on the increase in value between purchase and sale of the property. The level of withholding tax varies depending on double taxation treaties (DTT), but, as a rule of thumb, it's 25 per cent. In some instances, it can be as much as 50 per cent or as little as zero.



Michael Lefkowitz, pictured at the IR Dealmakers 2017 Conference in Barcelona.

You can obtain exemptions by application in Ontario, and most of the other provinces, depending on their land transfer tax regime. We usually have a treaty, but there are unusual cases.

There are no restrictions on foreign ownership in Canada, unless it's a corporation buying a large tract of land, but I've never seen that used.

**New York –RS** New York is an expensive jurisdiction in which to transact. It has several layers of stamp taxes and mortgage recording taxes, although no specific tax on foreign buyers.

One thing to consider is FIRPTA (Federal Investment in Real Property Tax Act). It's been around for many years and if you are not a US taxpayer you have to withhold 15 per cent of the purchase price pending clearance or release from the Internal Revenue Service (IRS).

That happens occasionally and is a burdensome aspect for a foreign investor. New York State has a similar rule for buyers who are not taxpayers in New York State.

**California –RB** The US, like Canada, has treaties with some countries that change those FIRPTA rules, and California also has a withholding tax that applies to non-Californian, or non-US buyers.

**Belgium –DV** Real estate transfer taxes are high in Belgium, being 10 per cent for the Flemish region, and 12.5 per cent in Brussels and in the French speaking Walloon Region. In Belgium, most real estate transactions are structured as a share deal rather than an asset deal because a share deal attracts in principle no real estate transfer tax.

Also in Belgium there is, in principle, no capital gains tax due if you do a share deal. This is heavily debated, but still the case, so you can sell the shares in your real estate company without transfer taxes or capital gains taxes on the shares. It can be very advantageous.

#### QUESTION 4

## What structure or vehicle should be used for purchases in your jurisdiction?

**Germany –PD** In Germany we optimise criteria in accordance with tax planning, liability issues, civil law and financing.

Very often an LLP is the best legal form for an SPV, but we also use that together with a general partner limited from the British Virgin Islands (BVI) or another offshore jurisdiction, in order to prove the buyer has no permanent establishment in Germany.

Under that scenario they are not obliged to pay trade tax, which is of enormous importance. This can have consequences though, because banks are expected to have a branch of the company registered in Germany for security purposes, which can damage the tax structure.

**Canada –JS** Corporations are used most often in Canada for real estate deals, but there is also the option to use a trust or a limited partnership. We look to the client's specific needs and fulfil them from a tax and liability perspective.

We use limited partnerships quite often because they allow for an operator to run a project and then have investors fall in behind. There is also the whole question of whether it needs listing on an exchange, since we have a number of large and small ones.

**New York –ML** In New York, the vehicle of choice is a limited liability company. Most lenders want the asset to be owned as a single purpose limited liability company and I have only run into issues with that structure when the investor is from a specific foreign jurisdiction (for instance the UK). The UK does not recognise the LLC as a tax saving structure for a single purpose entity, so it is taxed at both a corporate and an individual level.

**Canada –JS** That is true of Canada as well, we use other structures for those investors.

**California –RB** We often use a special purpose LLC for financing deals, but for foreign investors coming out of Latin American non-treaty jurisdictions, we frequently see the use of a US corporation as a holding company that will be the sole member of a US LLC to hold individual properties. The investors will fund that US corporation in different ways with debt instruments to try to take advantage of the portfolio interest exception, allowing them to move rents received out without being taxed.

There are very significant issues with a foreign individual directly owning real estate or shares in a US corporation. Frequently, the shares of a US holding company are owned by a foreign entity, so that on the death of that individual, the heirs don't wind up with an estate tax on the US investment.

**Belgium –DV** In Belgium buyers usually set up an SPV when acquiring real estate, allowing investors to ring-fence their investment and facilitate a disinvestment in the future.

The SPV often takes the form of a regular Belgian LLC. The incorporation process and corporate governance of Belgian companies is in general very straight forward.

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