THE GLOBAL OUTLOOK FOR JERSEY PRIVATE EQUITY REAL ESTATE

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Jersey has a long-standing and enviable reputation as a leading and well-regulated offshore financial centre, particularly for those establishing private equity real estate funds and other real estate investment structures. In considering recent trends in the Private Equity Real Estate (PERE) sector, it is worth focusing on why Jersey continues to be the destination of choice for international investors and PERE fund managers as a platform for international real estate investment.

REAL ESTATE MARKET OVERVIEW

As an international crossroads for cross-border investment, Jersey has direct visibility on the international real estate markets.

Since the financial crisis the continued low interest rate environment and the background of quantitative easing, has prompted a search for real investment returns. Post-crisis opportunities (arising from deleveraging and initial risk aversion) and the cyclical nature of real estate markets, have drawn opportunistic and value-add players into the real estate markets. As economic stability has increased and risk appetite from investors and institutions has grown, a broader pool of investors have been drawn back to real estate as an asset - with its relative safe haven and inflation-proofing characteristics.

In recent years, a number of private equity and hedge funds have established real estate investment platforms to diversify into the real estate sector, taking full advantage of the distressed sale of real estate portfolios or loans. Following swiftly on their heels has followed an abundance of capital from sovereign wealth funds, pension funds, institutional investors, family offices and high-net worth investors, mainly from the US, Middle East and Asia. The re-emergence of the availability of debt finance has further contributed to an increased demand for, and competitive pricing of, core real estate.
Large portfolio real estate transactions have been common, principally driven by demand from overseas investors, and ‘trophy’ buildings have been in demand (and consequently in increasingly short supply at attractive pricing levels).

An increasingly broad group of fund managers and investors have latterly been searching for opportunistic or value-add investments in the regions and the secondary cities in the UK, and more further afield, across Europe and more globally, including in the US and the Asian markets.

In terms of sectors, as well as offices and retail investments, fund managers have also focused on the industrial and logistics, hotel and leisure, and student accommodation sectors. Infrastructure funds have also been active.

**PERE FUNDS**

In 2015, closed-ended PERE funds raised $107 billion globally, according to Preqin statistics. North American focused funds led the way, raising $71 billion (67%), with European focused funds raising $23 billion (21%) and Asia focused funds raising US$11 billion (11%). Blackstone Real Estate Partners VIII alone raised a staggering $15.8 billion.

In the UK, commercial property investment levels were anticipated to exceed £70 billion by the end of 2015. In the first three quarters, nearly £50 billion of transactions had been completed. Nearly 50% of this capital for that period, £24.2 billion, originated from overseas investors (www.practicallaw.com).

In Jersey, according to statistics from the Jersey Financial Services Commission (JFSC), as at 30 September 2015, the net asset value of all
alternative funds administered in Jersey grew by 12% year-on-year to £159 billion, which includes rises of 2% in private equity and 16% in real estate funds. In addition, around 230 specialist real estate funds are regulated by the JFSC, with a total net asset value of £35 billion.

REGULATORY AND TAX CHALLENGES
Despite many regulatory complexities facing the funds sector, including the European Union’s Alternative Investment Fund Managers Directive (AIFMD) regime, US and UK Foreign Account Tax Compliance Act (and the Common Reporting Standard) and the intricacies of the OECD’s Base Erosion and Profit Shifting (BEPS) initiative, PERE fund establishment activity remains buoyant and continues to grow at a strong rate.

The JFSC and Jersey’s funds industry has been able to respond quickly, and to proactively adapt, to the international regulatory environments. Jersey, being outside the EU, offers a flexible regulatory regime which allows PERE funds and their fund managers to choose, if raising capital in the EU, to achieve an attractive balance between regulation (and the attendant compliance costs) and market access through the National Private Placement Regimes (NPPRs), or to sign up to full AIFMD compliance. For those focused on non-EU capital, or undertaking joint venture or proprietary investment structures, the option is there to remain outside of the AIFMD regime.

In 2015, according to JFSC statistics, there were 104 Jersey authorised alternative fund managers marketing, and 230 alternative investment funds being marketed into the EU through the NPPRs. Looking ahead, the European Securities and Markets Authority (ESMA) recommended that Jersey should be considered for EU-wide passporting, which is a vote of confidence in Jersey’s regulatory and fiscally transparent framework and augurs well for continued access to EU capital in the future.

A key focus for AIFMD and BEPS is the question of substance. An important factor in the success of Jersey’s funds industry is the ability to have real substance in respect of funds and other structures managed and administered in Jersey. The depth and expertise within Jersey’s financial services industry, particularly in respect of corporate governance (with a strong community of non-executive directors) is a significant factor in this success, ably supported by Jersey fund management and administration service providers, who have the necessary specialist expertise and personnel who really know and understand the PERE asset class.

JERSEY FUNDS WORK
Jersey provides a stable, well-regulated and internationally-recognised environment, providing a tax neutral platform for investment by PERE funds in real estate and is the destination of choice for investments into UK and pan-European markets.

Real estate structuring activity and transaction levels in Jersey have been high, particularly in relation to investments in the UK and Europe. In 2015, there were some notable ‘trophy’ building transactions in London and certain prime cities in Europe and a number of billion or multi million pound transactions in relation to same assets portfolio or diversified portfolio sales, including real estate in the office, logistic, hotels and student accommodation sector in the UK and pan-Europe.

A wide variety of the PERE fund structures are able to be established in Jersey, including private/joint venture funds, syndicated or ‘club’ fund structures, collective investment funds, listed REITs and fund of funds.

Apart from the traditional limited partnership PERE funds focusing on office, retail or industrial sectors in the UK or across the EU, there has been a growth in pan-European or global debt funds, infrastructure funds and global student accommodation funds, as fund managers look for value-add investments in different geographical areas.

Development activity has increased as funding became more readily available. A number of transactions have involved structuring ‘developer and funder’ joint ventures for large scale developments and regeneration projects. Existing investors have also sold interests in development projects, which have been acquired by overseas institutions or pension funds.

With the influx of Middle Eastern and Asian capital, the Jersey funds industry has adapted to offer innovative Shari’a-compliant fund and joint venture fund structures, principally UK and EU-focused. The post-crisis trend away from blind pool fund arrangements and the desire from institutional, sovereign wealth and family office investors to have closer involvement with the investment process, has led to an increased number of joint venture and club investment arrangements. It has also seen the emergence of certain ‘hybrid’ fund structures allowing investor discretion in respect of individual investments – for example funds which are structured as segregated cell companies offering investors segregation of assets and liabilities between cells and the ability to choose in which cell they wish to invest.

Certain joint venture funds have been converted into Real Estate Investment Trusts (REITs) and listed on the Channel Islands Stock Exchange (CISE), being an attractive option for investors wishing to enjoy the benefits of REIT status but not necessarily requiring liquidity or wishing to incur the costs associated with, for example, a London listing. Although a REIT must be UK tax resident, there is no restriction on the place of incorporation and Jersey companies are being chosen as the REIT vehicle.

There has also been a growth in the PERE secondary funds market, where funds have focused on acquiring interests in other real estate or debt funds which provides a certain amount of liquidity to investors. Global ‘tactical’ funds have also focused on acquiring established property companies including taking private listed property companies with a view to consolidation and subsequent exit.

In relation to debt funds, whilst the cost of finance remains low and loan-to-value ratios are relatively conservative, as a consequence there are a number of debt-focused PERE and hedge funds that focus on ‘gap’ funding opportunities by offering stretch senior or mezzanine finance over and above the bank’s senior debt LTV levels.

CONCLUSION
Jersey represents a stable, well-regulated and internationally-recognised environment for international capital flows, providing a tax neutral platform for investment by PERE funds in real estate, and is the destination of choice for investments into UK and pan-European markets.

The depth of expertise and experience in Jersey of cross border investment structuring – and the real estate sector – and Jersey’s engagement with and ability to meet international standards of governance and compliance, means that Jersey should be well placed to continue its role in the effective and efficient allocation of international capital into the real estate sector for many years to come.

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