FARRER&Co

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A Basic Guide to

SPV Real Estate Transactions

Contents

1. Introduction

An increasing number of buyers are considering the purchase of property through corporate acquisitions. This is due to the cumulative impact of recent stamp duty land tax (SDLT) increases, the introduction of higher rate SDLT for multiple ownership, and a desire for privacy among high value property owners. Under this structure, the buyer elects to purchase the company which owns a commercial or residential property asset, rather than purchasing the asset itself.

Parties to a corporate acquisition agreement often seek to replicate the same commercial position they would achieve through a pure property purchase but with tax and certain other benefits of a share purchase.

The purpose of this guide is to outline the key benefits and risks of structuring a property purchase by way of a corporate acquisition, and to set out some of the key documents and procedural steps involved.

2. Why use a corporate structure for a property acquisition?

Where a property is already held in a company, often referred to as a special purpose vehicle (SPV), a buyer should consider whether to acquire the SPV rather than acquiring the property itself. One benefit of using such a structure is the potential tax saving of SDLT. SDLT would be charged on the acquisition of property in the UK, but not on the acquisition of shares in a company. When shares in a company are acquired, stamp duty applies instead of SDLT. However, (a) no UK stamp duty is payable on the purchase of shares in a foreign company, and (b) the stamp duty rate for shares in a company incorporated in England & Wales is just 0.5 per cent. With top up SDLT rates for a residential property now at 17 per cent, there are potentially significant savings to be made in buying a company rather than the property. There are additional tax considerations, such as the payment of the Annual Tax on Enveloped Dwellings (ATED). ATED imposes an annual tax on companies that own UK residential property and is something to be considered against a potential SDLT saving.

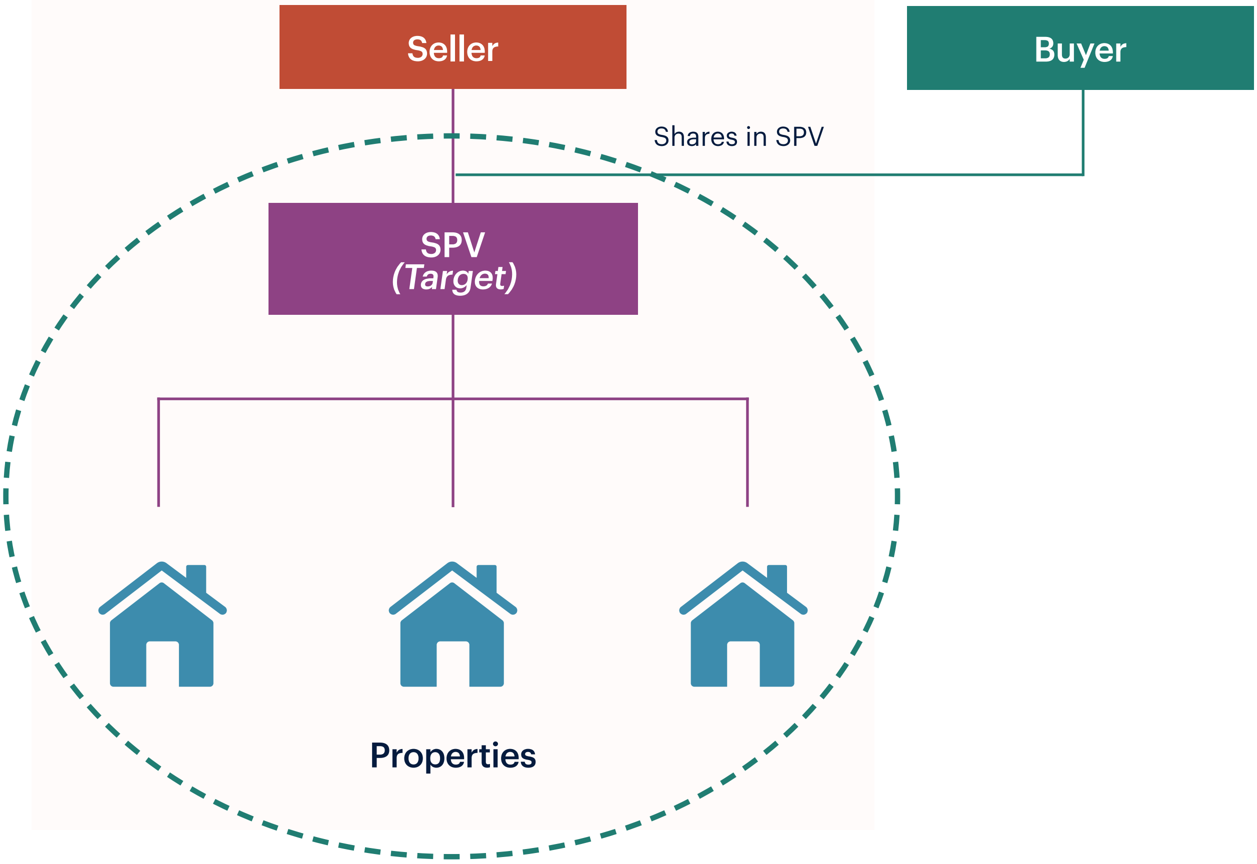
Other benefits of acquiring an SPV include:

- The ease of transfer of associated assets. In circumstances where the SPV holds assets in addition to the property, those assets (including, for example, contracts) will automatically transfer to the buyer as they are already held in the SPV.
- If a buyer is acquiring a portfolio of property assets it may be easier to acquire the holding company of those assets rather than each asset being conveyed individually.

There are also risks associated with the acquisition of the SPV rather than the property itself. An SPV buyer is assuming ownership of the SPV along with all of its assets and liabilities. Legal, tax and accounting advisers will need to carry out a thorough review of the SPV to understand the activities it has undertaken since incorporation and advise the buyer on any risks associated with acquiring the SPV over just the asset. We discuss this in more detail later in this guide.

Typically, the advisory costs associated with a SPV transaction will be higher than a simple property sale (given the additional risks which could be assumed by a buyer). An SPV purchase is also often a significantly longer process than an asset purchase. There are therefore important commercial considerations when contemplating whether an acquisition of the SPV is a sensible option.

3. Typical structure of an SPV acquisition



1. Typically, a seller will own 100 per cent of the shares in the SPV, either directly or indirectly via a trust.

   The SPV may be incorporated in the UK or more commonly in an overseas jurisdiction such as British Virgin Islands, Jersey or Cayman Islands.

   The SPV owns the property or properties.

2. In an SPV acquisition, the shares in the SPV will be sold by the seller to the buyer. The terms of this sale will be set out in a share purchase agreement (SPA).

   Effective ownership of everything within the dotted circle will be transferred to the buyer following completion.

Key differences between a property and SPV purchase

	Property Purchase	SPV Purchase
When does risk pass?	On exchange of contracts the parties are bound to complete and at this point risk passes to the buyer (unless otherwise agreed in the contract) (**Exchange**). The legal title does not pass until completion.	On exchange the parties are bound to complete but ownership does not pass until completion of the transaction (**Completion**). However, there is scope to include bespoke provisions in the SPA giving the buyer the right to walk away between exchange and completion eg including a material adverse change clause.
What due diligence enquiries are common?	Standard property enquiries arising from the due diligence documents for the property including any documents provided by the seller's solicitors, the property searches and usually the building's survey all of which are required to ensure that the property has a good and marketable title.	Standard property enquiries, plus additional enquiries and warranties in SPA and a Disclosure Letter.
Risk being assumed	'Buyer beware': As a general principle, the onus is on the buyer to make enquiries and satisfy itself as to the risks attached to acquiring the property. In the absence of fraud, there is limited recourse against the seller in respect of liabilities identified after the sale.	'Buyer beware', but subject to warranties given by the seller: The general principle of 'buyer beware' also applies to an SPV sale, where the onus is on the buyer to investigate the risks attached to the SPV and underlying property. However, the seller will also be expected to give warranties and indemnities under the SPA (see below for further details). This does mean the seller is more likely to have residual risk after the sale.
What is the cap on seller's liability	Generally there is no cap.	The SPA will usually include a cap on liability which is negotiated, but will typically be based on the purchase price or the net asset value of the SPV, or a portion of the same.
What is the threshold for claims?	None.	There is normally a minimum threshold for individual claims and a threshold for aggregated claims which must both be exceeded before a claim can be made by a buyer – these thresholds will be set out in the SPA.
What are the limitation periods for claims?	six or 12 years.	Non-tax warranties: one to three years. Tax warranties and indemnities: usually seven years.
Are any protections given against environmental risks?	Not common.	Negotiable.

4. Key documents required for the acquisition of an SPV

Non-Disclosure Agreement (NDA): Although the due diligence process, whereby a buyer is provided with information relating to the SPV, is controlled by the seller, it may involve permitting access to some sensitive or confidential information. The parties will often enter into an NDA to ensure that the information will be kept confidential. In the context of a simple SPV transaction, the parties may feel that an NDA is not necessary.

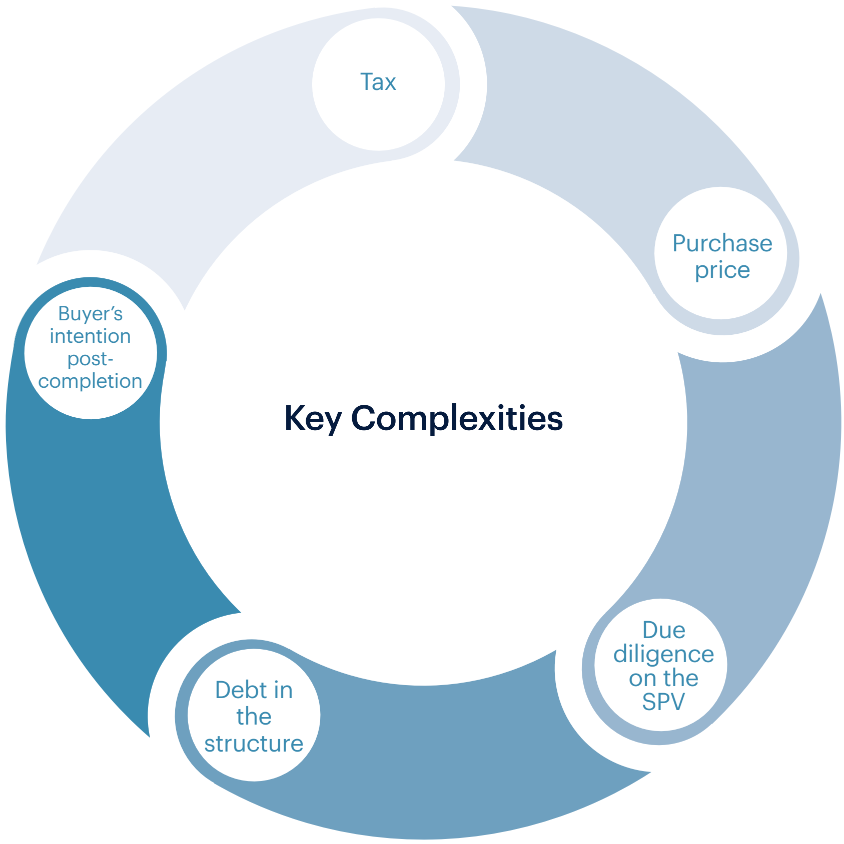
Heads of Terms: Before the detailed sale documents are drafted, the parties will usually agree a basic framework for the deal in a **Heads of Terms** document (often referred to simply as the **Heads**). Although this document may only run to two or three pages and is usually expressed to be non-binding on the parties, the Heads ensure that there is agreement in principle on all key terms of the transaction before significant time and money are invested in the full sale process. Whilst it may be tempting not to involve lawyers and accountants at this preliminary stage, the Heads are an important document that should have professional input before being signed. Tax advice at this early stage will also be important to ensure the deal framework gives the seller the benefit of any available reliefs and the buyer the benefit of any intended SDLT saving.

Share Purchase Agreement (SPA): This is the principal transaction document for the acquisition of the SPV. It includes all the terms in detail and the operative parts are likely to be the subject of a significant amount of negotiation. The SPA also contains the **warranties**, which are key buyer protections. These are contractual statements made by the seller which provide assurances to the buyer about various aspects of the company and its assets and liabilities. If such statements are untrue and the buyer subsequently suffers a loss, it may give the buyer a right to bring a claim against the seller in respect of such losses. The SPA may also include **indemnities**, including a tax indemnity. See below for further information under 'Buyer Protections'.

Disclosure Letter: Second only to the SPA in terms of importance (and negotiated alongside it) is the Disclosure Letter. One of the key differences between a straight property acquisition and an SPV acquisition is that the buyer will need to be comfortable with the risks associated with acquiring the SPV which holds the property (not just the property itself). It does this by seeking warranties in the SPA, as explained above. A key seller protection is the Disclosure Letter which is the main mechanism by which a seller protects themselves against a **warranty** claim. It is used to "fix" the buyer with knowledge about the SPV and its business which may be inconsistent with the warranties; if a warranty given in the SPA is breached, providing the relevant matter has been fully and fairly **disclosed** to the buyer in the Disclosure Letter, the buyer is prevented from bringing a claim (because the buyer has accepted that it is entering into the transaction with knowledge of the matter). If the SPV is simply a holding vehicle and has undertaken no other activity then a Disclosure Letter may not be required, or if it is, it should be a very short document.

Ancillary Documents: In addition to these key documents, there will be a potentially sizable suite of **ancillaries** required. This includes board minutes, shareholder resolutions, Stock Transfer Forms, Companies House filings and client communications, all of which are important to the transaction but which are not usually the subject of significant negotiation.

5. Key considerations in an SPV transaction



Tax

- The buyer will, by default, inherit any tax-related risks or liabilities of the SPV after the purchase. While SPVs are often sold as being 'clean', very few are free of tax risks or liabilities altogether. These can sometimes be significant enough to defeat any SDLT saving obtained by buying the SPV, rather than the property, in the first place. Tax due diligence should therefore be undertaken by buyers as early as possible. It is also common for sellers to offer a tax indemnity (or 'covenant') in respect of certain pre-sale tax risks for this reason.

- Buyers should also seek early tax advice to ensure that buying the SPV in the way envisaged yields any intended SDLT saving factoring in any possible tax implications such as ATED which could effectively eat into any potential saving. This can be a particular issue where buyers intend to later hold the property in their individual name, which is often a way to reduce ongoing tax compliance, administration costs and risks associated with holding some residential properties in companies. Further information on SDLT risk is available here.

- Sellers will wish to ensure that they have full visibility on any tax exposure they might have on selling the SPV. As a general rule, sellers of SPVs in these situations will be potentially exposed to UK corporation or capital gains taxes (wherever they are based), so any potential liability should be identified early.

Purchase price

- The parties will need to agree what the purchase price is for the SPV. The starting point is usually the commercially agreed value of the underlying property. However, the actual purchase price to be paid for the SPV shares will be an adjustment to that price, typically calculated to reflect the net asset value of the SPV which will take into account any cash and debt held within the SPV. The purchase price will also need to reflect the SPV's income and outgoings which is normally apportioned on an accrual basis. The purchase price will therefore be adjusted to reflect outgoings such as council tax, service charge, rent etc. and this will be reflected in the 'Apportionments' clause of the SPA.

- The purchase price will also need to reflect: (a) any debt owing by the SPV to the seller (or other associated parties) which is usually referred to as 'Shareholder Debt', and (b) any debt owing by the SPV to third parties (such as a bank or a developer).

Due diligence, disclosure and warranties

As already set out above, one of the key risks of a buyer acquiring an SPV rather than the property directly is that the buyer will be assuming all of the liabilities of the SPV. As such it is extremely important that the buyer's advisers carry out thorough due diligence of the SPV to understand what activities the SPV has undertaken since incorporation. This will involve corporate, finance and tax due diligence of the SPV as well as property due diligence of the underlying property. How long this process will take and how expensive it will be will depend on how much activity the SPV has undertaken since incorporation. If the SPV is incorporated outside of the UK, overseas counsel in the jurisdiction of incorporation will need to be appointed and this will add complexity and cost to the transaction.

Is there debt in the structure?

It is not uncommon for an SPV to have taken on third party debt, particularly where the underlying property might have been developed during the seller's ownership. If there is debt in the structure, it would also be common for the debt to be secured against the property and sometimes the shares of the SPV. As part of the completion mechanics of the transaction, the debt will likely be repaid and the lender will need to be involved so that the security (if there is any) can also be released when the loan is repaid. It may be that the buyer is funding the purchase by way of part cash and part debt and this can add further complexity as the new lender will also need to be involved in the mechanics of the transaction. Debt structuring can have a particular significance for SDLT purposes, so any mechanics relating to debt should be checked early to ensure this does not risk any intended SDLT saving.

What are the buyer's intentions following completion?

The buyer may wish to de-envelope the property following completion, which means removing it from the corporate structure and winding up the SPV. The costs of undertaking a de-envelopment will need to be considered as the costs involved can outweigh the tax savings.

6. Buyer protection

Because of the increased risks involved with a corporate acquisition, buyers will usually require a number of additional protections:

Warranties and indemnities

The SPA will usually include warranties from the seller offering contractual assurances, for example that the company:

- Is properly incorporated,
- Has no debts/liabilities,
- Owns the property,
- Accounts give a true and fair view of the company,
- Has paid its taxes, and
- Is of good standing.

These warranties are typically given by the selling shareholders, but may also be sought from underlying beneficiaries (**other warrantors**) where the SPV is held in a trust structure. In the event that the warranties are untrue and the buyer suffers a loss as a result, this may give rise to a claim for damages against the seller (or other warrantors) in respect of such loss suffered.

- Where a specific issue is identified in the due diligence process, an indemnity may also be sought from the seller, pursuant to which the buyer would expect a pound-for-pound recovery from the seller in respect of any costs or losses associated with the matter. It is common for sellers to offer an indemnity (or 'covenant') for certain pre-sale tax risks and liabilities.
- The buyer will be relying on the covenant strength of the seller (and other warrantors) in the event that they need to enforce a damages claim or recovery under an indemnity. Where the seller itself is an offshore entity or trust and/or has no assets other than the shares in the company these warranties and indemnities alone may not be sufficient comfort for the buyer. In these circumstances it is common practice for additional buyer protections to be negotiated.

Retention monies held in escrow

- The SPA can provide for an agreed sum to be retained from the purchase price and held in a separate account for a fixed period of time. The (non-tax) warranty limitation period is commonly 12-36 months and ideally a buyer would want the retention held for the duration of the warranty period.

- The limitation period of the tax warranties is usually seven years (the period of time in which HMRC can reopen tax affairs of a company). It is rare for a seller to be willing to have a retention sum held for this long so the parties will need to negotiate to determine who bears this risk.

Insurance

- An insurance policy can be obtained to cover the cost of a warranty claim. See section below on W&I Insurance. Insurance can also be obtained to cover certain tax risks.

Guarantor

- If an ultimate beneficiary (or other connected individual of substance), particularly with UK assets, is willing to stand behind the terms of the SPA as guarantor this may give the buyer greater comfort that they will have recourse in the event of a breach of the SPA.

7. Insurance (including W&I insurance)

It is now possible to insure against breach of an SPA. This type of insurance is called 'Warranty & Indemnity Insurance' or 'W&I Insurance' and it is becoming increasingly common that the parties in an SPV transaction agree that a W&I policy should be taken out.

The benefits of taking out a W&I policy for sellers are that:

- It will give the seller a clean exit without the potential of risk of a potential warranty claim following completion,
- It may increase the attractiveness of the SPV,
- The W&I policy allows a seller to cap its liability far lower than it would be able to without the insurance in place.

The key benefit for a buyer is that claiming under a W&I policy removes the risk of a seller not being willing or able to pay out should a warranty claim arise.

The disadvantages of taking out a W&I policy are:

- The premium can be expensive (it is negotiable as to who should cover the cost),
- Certain losses may not be covered and the insurer can carve out certain risks within the policy,
- Insurers expect a thorough due diligence process to have been conducted by the buyer and for the a seller to have conducted a thorough disclosure process,
- Insurers will usually require sellers to pay an initial excess amount before the policy will kick in, and
- The parties need to bring the insurer into the process as early as possible as the insurer will want to review the SPA and have access to the data room and this could delay completion if they are brought in late to the transaction.

Whilst either buyer or seller can technically be insured, most W&I polices are taken out by buyers. The premium rates will depend on factors such as the jurisdiction of the SPV, governing law of the SPA, scope of warranties etc. The premium is paid as a one-off payment at the start of the policy.

There are other types of insurance policies which can be taken out including specific tax insurance policies and title insurance policies.

8. Seller limitations

It is unusual for a seller to have unlimited liability for breaches of the SPA and the agreement will set out the agreed limitations. The terms of these limitations will be negotiated, but it is standard practice for the SPA to contain, amongst others, financial limitations on claims including a de minimis (to exclude smaller claims) and a maximum cap (which is often the purchase price).

9. Completion and post-completion

Once both parties are ready to contract, the parties will proceed to exchange contracts, referred to as '**exchange**'. As with a straightforward property sale, there is often a gap following exchange to allow for certain conditions to be satisfied (eg ensuring any existing security will be released). Following satisfaction of any conditions in the SPA, lawyers for the buyer and seller will coordinate to ensure all signed documents and other **deliverables** (eg keys, company books, banking fobs, chequebooks) required to complete the purchase are handed over (or are in the control of the lawyers who can give an **undertaking** to do so on behalf of their clients). At this point, any payment due at completion is paid to the seller and the deal is formally concluded.

The final steps in a share sale are usually:

- Updating the SPV's statutory books,
- Filing of the various Companies House forms (or other relevant overseas register) and other statutory notifications to reflect the new ownership and control of the SPV,
- Payment of Stamp Duty (if applicable), and
- The "settle up" of any price adjustment or apportionment process outlined in the SPA.

10. Conclusion

Whilst there are potential savings to be made by a corporate acquisition of a property, there are also associated risks. Whether it is advisable to proceed with a purchase by way of a corporate acquisition will depend on a number of factors and additional legal, tax and accounting advice will all be required.

The Corporate, Property and Tax teams and Farrer & Co have a great deal of experience in this area. Please do get in touch if you are considering an acquisition of a property and would like advice on the property purchase and in particular how best to structure the acquisition.

11. Glossary

Ancillaries an umbrella term for supporting documentation such as board minutes, shareholder resolutions, Stock Transfer Forms and Companies House filings that are required to implement a transaction.

ATED Annual Tax on Enveloped Dwellings.

Completion the point at which the deal is legally concluded and ownership of the SPV transfers to the buyer.

Data Room the (physical or virtual) collection of documents and data made available to a prospective buyer and its advisers for the purpose of undertaking due diligence.

Deliverables a general term for documents and physical items to be delivered by either party at completion.

Disclosed any fact, matter, event or circumstance which the seller confirms to the buyer during the course of the due diligence process. There are often restrictions included in the SPA of what 'disclosed' means and this is often that a matter is only disclosed if it has been fairly disclosed in sufficient detail to enable the buyer to identify and understand the issue and the matter must be included in the Disclosure Letter. Broader and narrower wording can be negotiated in the SPA, however.

Disclosure the formal process by which a buyer is fixed with knowledge of matters that are inconsistent with the warranties.

Due diligence/ DD the initial process of investigation into the SPV undertaken by a buyer (with separate processes being undertaken for legal, financial and regulatory aspects).

Exchange the point at which the SPA is signed, and the deal becomes binding on the parties, prior to completion.

Heads (of Terms) a (largely non-binding) document setting out the key terms of the proposed transaction.

Indemnity an undertaking given by a seller to a buyer to pay in full for any loss or costs incurred or associated with a particular matter.

Material Adverse Change/MAC an event or circumstance which has a material negative impact on the SPV or its business and which may give rise to a right to rescind the SPA.

Non-Disclosure Agreement/NDA a document which the parties will often enter into at the beginning of a transaction so as to ensure that confidential information is protected. An NDA can be mutual or on-sided eg where the NDA protects the information of the seller but not the buyer.

SDLT Stamp Duty Land Tax.

Share Purchase Agreement/SPA the principal transaction document where a buyer agrees to buy and a seller agrees to sell shares in the SPV.

SPV special purpose vehicle which, for the purposes of this article, owns the property(s) in question.

Undertaking a binding commitment given by a solicitor to do or cause something to be done (usually used to facilitate completion if payments, documents or other deliverables are not physically in the hands of the parties at that time).

Warrantor the party providing warranties to the buyer, most commonly this is the seller but may also include other beneficiaries (who we refer to in this article as other warrantors).

Warranty an assurance given by a seller to a buyer as to the state of the SPV or any part of its business.

12. Key Contacts

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