The Real Estate M&A and Private Equity Review

Editors
Adam Emmerich and Robin Panovka

Law Business Research
The Real Estate M&A and Private Equity Review

Editors
Adam Emmerich and Robin Panovka

Law Business Research Ltd
THE LAW REVIEWS

THE MERGERS AND ACQUISITIONS REVIEW
THE RESTRUCTURING REVIEW
THE PRIVATE COMPETITION ENFORCEMENT REVIEW
THE DISPUTE RESOLUTION REVIEW
THE EMPLOYMENT LAW REVIEW
THE PUBLIC COMPETITION ENFORCEMENT REVIEW
THE BANKING REGULATION REVIEW
THE INTERNATIONAL ARBITRATION REVIEW
THE MERGER CONTROL REVIEW
THE TECHNOLOGY, MEDIA AND TELECOMMUNICATIONS REVIEW
THE INWARD INVESTMENT AND INTERNATIONAL TAXATION REVIEW
THE CORPORATE GOVERNANCE REVIEW
THE CORPORATE IMMIGRATION REVIEW
THE INTERNATIONAL INVESTIGATIONS REVIEW
THE PROJECTS AND CONSTRUCTION REVIEW
THE INTERNATIONAL CAPITAL MARKETS REVIEW
THE REAL ESTATE LAW REVIEW
THE PRIVATE EQUITY REVIEW
THE ENERGY REGULATION AND MARKETS REVIEW
THE INTELLECTUAL PROPERTY REVIEW
THE ASSET MANAGEMENT REVIEW
THE PRIVATE WEALTH AND PRIVATE CLIENT REVIEW
THE MINING LAW REVIEW
THE EXECUTIVE REMUNERATION REVIEW
The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

ALI BUDIARDJO, NUGROHO, REKSODIPUTRO
ANJARWALLA & KHANNA
ARTHUR COX
BONELLIEREDE
CYRIL AMARCHAND MANGALDAS
D’EMPAIRE REYNA ABOGADOS
DE BRAUW BLACKSTONE WESTBROEK NV
EGOROV PUGINSKY AFANASIEV & PARTNERS
GALICIA ABOGADOS
GORRISSEN FEDERSPIEL
HERBERT SMITH FREEHILLS
JUNHE LLP
MARVAL, O’FARRELL & MAIRAL
NISHIMURA & ASAHI
OSLER, HOSKIN & HARCOURT LLP
PINHEIRO NETO ADVOGADOS
SLAUGHTER AND MAY
URÍA MENÉNDEZ
WACHTELL, LIPTON, ROSEN & KATZ
WARDYŃSKI & PARTNERS
WHITE & CASE LLP
CONTENTS

Editors’ Preface ........................................................................................................... v
Adam Emmerich and Robin Panovka

Chapter 1
ARGENTINA ................................................................. 1
Santiago Carregal and Diego A Chighizola

Chapter 2
AUSTRALIA ................................................................. 11
Philip Podzebenko and Robert Bileckij

Chapter 3
BRAZIL ................................................................. 32
Henry Sztutman and Flávio Coelho de Almeida

Chapter 4
CANADA ................................................................. 47
Chris Murray and Jack Silverson

Chapter 5
CHINA ................................................................. 67
Sammuel (Xiyong) Zhao

Chapter 6
DENMARK ................................................................. 75
Hans-Peter Jørgensen and Michael Wejp-Olsen

Chapter 7
GERMANY ................................................................. 84
Stefan Feuerriegel

Chapter 8
INDIA ................................................................. 92
Cyril Shroff, Reeba Chacko, Nagavalli G and Vandana Sekhri

Chapter 9
INDONESIA ................................................................. 103
Oene Marseille, Emir Nurmasyah and Gustaaf Reerink

Chapter 10
IRELAND ................................................................. 113
Paul Robinson, Ailish Finnerty and Sophie Frederix
Chapter 11  ITALY ................................................................. 125
            Alessandro Balp

Chapter 12  JAPAN ............................................................ 137
            Masakazu Iwakura and Hajime Ueno

Chapter 13  KENYA ............................................................ 148
            Anne Kiunuhe, Mona Doshi, Daniel Ngumy and Caroline Karugu

Chapter 14  MEXICO ........................................................... 159
            Alejandro Trujillo

Chapter 15  NETHERLANDS ............................................... 170
            Lodewijk Hijmans van den Bergh, Mark Rebergen
            and Frederik Corpeleijn

Chapter 16  POLAND .......................................................... 179
            Izabela Zielińska-Barłożek, Łukasz Szegda, Michał Nowacki,
            Michał Wons, Maciej Szewczyk and Marcin Pietkiewicz

Chapter 17  RUSSIA ........................................................... 189
            Andrey Mashkovtsev

Chapter 18  SPAIN ............................................................... 199
            Yasser-Harbi Mustafá and Ángel Maestro

Chapter 19  UNITED KINGDOM ........................................... 208
            Richard Smith and Chris Smith

Chapter 20  UNITED STATES ............................................... 221
            Adam Emmerich, Robin Panovka and Matthew MacDonald

Chapter 21  VENEZUELA ..................................................... 232
            Fulvio Italiani, Carlos Omaña, Arnoldo Troconis and Inés Parra

Appendix 1  ABOUT THE AUTHORS .................................... 235

Appendix 2  CONTRIBUTING LAW FIRMS’ CONTACT DETAILS..... 251
EDITORS’ PREFACE

Publicly traded real estate companies and real estate investment trusts (REITs), with help from real estate private equity, have transformed the global real estate markets over the past 20 years. Their principal innovation, and secret sauce, is ‘liquid real estate’. Unlike traditional property ownership, equity in publicly traded real estate vehicles is highly liquid and can be bought and sold in large volumes, literally in minutes, on numerous global exchanges.

Publicly traded real estate vehicles have an aggregate market capitalisation of over $1.6 trillion globally, including about $1 trillion in the United States and $200 to 300 billion in each of Europe and Asia. As public REITs and other vehicles have aggregated these properties and grown in scale and sophistication, so too have real estate-focused private equity funds, playing an important role catalysing hundreds of billions of dollars of REIT and real estate M&A transactions and IPOs.

Yet, despite the massive growth, the potential growth is far larger, both in long-standing REIT markets and in newer REIT jurisdictions where the trend is more nascent. With increasing development and urbanisation, the world is producing more and more institutional-grade properties, and a growing percentage of this expanding pool – an estimated $5 trillion, and counting, so far – will inevitably seek the advantages of liquidity by migrating to the publicly traded markets. The growth is expected to be both local and cross-border, with more than 40 countries already boasting REIT regimes.

REITs and other vehicles that hold liquid real estate have grown because they are often a superior vehicle for stabilised assets. Greater liquidity and transparency – and often superior governance – create demand from investors, resulting in a lower cost of capital and superior access to the capital markets. In addition to cheaper capital, REITs and other public vehicles benefit from efficiencies of scale, sophisticated management and flexible deal structures, to name just a few advantages. With these advantages, the global march of real estate to the public markets seems unstoppable.

This volume is a multinational guide for understanding and navigating the increasingly complex and dynamic world of liquid real estate and the transactions that produce it. The sea change in the markets has meant that major real estate transactions have migrated from ‘Main Street’ to ‘Wall Street’. They now often take the form of mergers, acquisitions, takeovers, spin-offs and other corporate transactions conducted in the public markets for
both equity and debt. They have grown exponentially in complexity and sophistication, and increasingly represent cross-border multinational transactions fuelled by the now global real estate capital markets and M&A deal professionals. And they are often intermediated by international investment banks rather than local brokers, and financed with unsecured bonds or commercial mortgage-backed securities. In a fair number of cases they are instigated by private equity firms or similar catalysts, sometimes building portfolios to be taken public or sold to public real estate companies, and sometimes through buyouts of public real estate companies for repositioning or sale.

To create this volume, we have invited leading practitioners from around the globe to offer practical insights into what is going on around the conference table and in the markets in their jurisdiction, with an eye to cross-border trends and transactions. As will quickly become evident, the process of liquefying real estate, and the transactions that produce it, requires a melding of the legal principles, deal structures, cultures and financial models of traditional real estate, public company M&A and private equity. None of this, of course, happens in a vacuum, and the transactions often require expertise in tax, corporate and real estate law, not to mention securities laws and global capital markets. Each of our distinguished authors touches on these disciplines.

We hope this compilation of insight from our remarkable multinational authors produces clarity and transparency into this exciting world of ‘liquid real estate’ and helps to further fuel the growth of the sector.

Adam Emmerich and Robin Panovka
Wachtell, Lipton, Rosen & Katz
New York
August 2016
Chapter 13

KENYA

Anne Kiunuhe, Mona Doshi, Daniel Ngumy and Caroline Karugu

I OVERVIEW OF THE MARKET

The real estate sector has rapidly grown to become one of the key contributors to the Kenyan economy, with a booming property market responding to extraordinary demand from an emerging middle class for high-end residential, retail and office space and facilities. This growth may be attributable to the increased investment in real estate companies by private and public-listed investors and the development of new real estate models such as real estate investment trusts (REITS) within the Kenyan market.

Recent trends in the market have seen the establishment of real estate development companies with the capacity to undertake large-scale property development projects. One such company is Centum Investment Company Limited, a company established in 1967 as an affiliate of a Kenyan state corporation and which is now listed on both the Nairobi Securities Exchange (NSE) and Uganda Securities Exchange. Since 2014, Centum has been developing the Two Rivers development, a five-year, 100-acre fully integrated mixed-use development in Gigiri, Nairobi County, which in 2016 is valued at over US$166 million.

Other major listed real estate companies include Home Afrika, which was listed on the NSE in 2013 undertaking various large-scale real estate development projects including Migaa, an integrated golfing estate on approximately 800 acres of land in Kiambu County.

1 Anne Kiunuhe, Mona Doshi and Daniel Ngumy are partners, and Caroline Karugu is a senior associate at Anjarwalla & Khanna.
4 Such developments include: Migaa, Mitini, Tamarind Residence Migaa, Llango, Lakeview Heights and Kantafu Gardens.
It should be noted that the concept of REITs is fairly new in Kenya, with regulations for the same having only been gazetted in 2013 under the Capital Markets Act. The first Kenyan REIT® was the Stanlib Fahari I-REIT, issued by Stanlib Investments in October 2015. It had also been reported that the NSE intended to list two new REITs in the first quarter of 2016; however, so far this has not materialised.

In contrast to REITs, private equity firms have been very active in investing in the real estate sector in Kenya in the recent past, and according to a survey by Deloitte and Touche, one of the favoured destinations for private equity activity in Africa is Kenya. One significant recent deal in Kenya was a US$100 million joint venture entered into by Helios Investment Partners, a leading Africa-focused private equity fund and Acorn Group, a with large property developer providing capital for Acorn’s acquisition, construction and development of various real estate projects in the country. This joint venture followed the acquisition by investment firm British American Asset Managers (Britam) of a 25 per cent stake in Acorn in 2013 for the financing of Acorn’s development projects. It should be noted that in 2015, Britam entered into an agreement with Helios to relinquish its stake in the property developer.

In terms of foreign direct investment (FDI) into Kenya, there has been a significant increase in funding for projects since 2013 with more than US$500 million-worth of FDI in 2013 and nearly US$990 million-worth of FDI a year later in 2014. A notable FDI transaction involved Centum, which received funding by way of an equity investment of 6.4 billion Kenyan shillings in April 2015 from Aviation Industry Corporation of China.


(AVIC), a Chinese state corporation, for its mixed-use real estate project at Two Rivers, which was reported to be one of the largest foreign direct investments in the region from a Chinese state corporation to a private enterprise.

II RECENT MARKET ACTIVITY

i M&A transactions
With regards to M&A transactions, there has not been much significant activity in the sector recently as most investors opt for joint venture or private equity models. However, in 2016 a key M&A deal saw Old Mutual, a UK-based financial services group, and Centum reach an agreement for the acquisition by Old Mutual of a 50 per cent stake in Two Rivers Lifestyle Centre Limited (which in turn owns Two Rivers mall, which makes up a portion of the larger Two Rivers development) for 6.4 billion shillings. Old Mutual had also acquired a majority stake in UAP Holdings in 2015 after buying out three private equity firms that held a combined 37.33 per cent stake.13 UAP Holdings is an insurance firm with sizeable commercial real estate portfolio and projects including Union House, Equity Centre, Telkom Plaza and UAP Towers, which is currently the tallest building in Nairobi.

Also in 2015, Britam finalised its acquisition of 2.7 billion shillings-worth of shares in Housing Finance, which is the leading mortgage provider in Kenya and which also undertakes real estate developments.

ii Private equity transactions
In private equity, the most significant transaction relates to the construction of Garden City, a US$250 million integrated mixed-use property development along the Nairobi–Thika superhighway in Nairobi County, which comprises a 500,000 square feet shopping centre, offices, hotel and 600 residential units. It has been developed by Actis, a leading private equity investor partnering with CDC, the UK’s Development Finance Institution, and the International Finance Corporation (IFC), and was opened to the public in May 2015.15

Private equity firms are increasingly enhancing their presence in the real estate sector in Kenya. Traditionally, most real estate developments have been undertaken by family-owned companies that owned prime undeveloped land. The landowners acquire bank debt and undertake the development on their own or alternatively partner with individual developers to undertake the development. Some of the large real estate developments that have been undertaken in this manner are the Edenville development (situated along Kiambu Road, approximately 10 kilometres from Nairobi’s city centre), which, when completed, will comprise approximately 800 residential town houses, the Karibu Homes development (situated in the Nairobi County), which will comprise 1,000 low-end residential units, and the Greenspan Estate (situated in the Nairobi County), a mixed-use development comprising a shopping centre and residential homes made up of apartments and townhouses. Information regarding the value of these developments is not in the public domain.

III REAL ESTATE COMPANIES AND FIRMS

i Publicly traded REITs and REOCs – structure and role in the market

In 2013, the Capital Markets Authority of Kenya (CMA) introduced the Capital Markets (Real Estate Investment Trusts) (Collective Investment Schemes) Regulations (the REIT Regulations). The REIT Regulations provide for the legal framework for REITs and establishes two classes of REIT:

a development and construction real estate investment trust schemes (which provide for investment in development and construction projects) (D-REITs); and

b income real estate investment trust schemes (which provide for investment in existing income-generating real estate projects) (I-REITs).

The REIT Regulations regulate the offers and listing of REITs, management of REITs, the specific requirements of each type of REITs, and also provide for the establishment of Islamic REITs.

A validly issued REIT is required to (1) be established under a trust deed, (2) be structured as an unincorporated common law trust divided into units and (3) have a trustee, a REIT manager and a promoter. The roles and requirements of the trustee, REIT manager and the promoter are set out in detail in the REIT Regulations.

D-REITs, in which the investors pool their monies together for purposes of acquiring real estate with a view to undertaking development, construction projects and associated activities, may be structured as open-ended or closed-ended funds and may be converted from one status to another.

An offer or issue in a D-REIT may only be made as a restricted offer to professional investors in minimum subscription parcels of 5 million shillings.

---


I-REITs, in which the investors pool their monies for purposes of acquiring long-term income-generating real estate including housing, commercial and other real estate, may be the subject of either restricted or unrestricted offers but may only be structured as closed-ended funds.\(^\text{18}\)

REITs can only invest in eligible real estate, which is defined under the REIT Regulations as real estate situate in Kenya and which has an unexpired residual term of 25 years. This means that REITs listed in Kenya cannot invest in property situated outside Kenya.

Section 20 (c) of the Income Tax Act (ITA)\(^\text{19}\) provides that unit trusts and REITs registered by the Commissioner ‘shall be exempt from income tax except for the payment of withholding tax on interest income and dividends as a resident person as specified in the Third Schedule to the extent that its unit holders or shareholders are not exempt persons under the First Schedule’. All distributions of income and all payments for redemption of units or sale of shares received by unit holders are deemed to have already paid tax. This means that a REIT (being a separate and distinct vehicle from its unit holders) is tax-exempt provided it meets the criteria set out above. The dividend distribution to the unit holders in the REIT will, however, be subject to withholding tax.\(^\text{20}\) Any interest paid on loans by the REIT to its unit holders will also not be exempt from withholding tax.\(^\text{21}\)

A REIT is tax efficient because there is no corporation tax paid on trading gains, as would be the case with a corporate entity (the corporate tax rate is 30 per cent). Where a REIT has been listed on the NSE, the trading of units is not subject to capital gains tax or stamp duty, making REITs very tax efficient when undertaking real estate development.

ii Real estate PE firms – footprint and structure

As previously mentioned, the Stanlib Fahari I-REIT is the only REIT so far listed in Kenya. Stanlib offered 625 million units priced at 20 shillings each during the initial public offer, targeting a maximum of 12.5 billion shillings but was only able to raise 3.6 billion shillings owing to what was reported as ‘competition from other instruments and the market’s poor grasp of the concept’.\(^\text{22}\) The REIT listed on the NSE having surpassed the minimum threshold required of 2.6 billion shillings. It is currently in the process of finalising the acquisition of the Greenspan Mall shopping centre for approximately 2 billion shillings.

Most private equity firms in Kenya enter into joint venture (JV) agreements with landowners in which the private equity firm finances development activities with an aim of exiting the project after a certain number of years. Some private equity firms, however, opt to acquire land and develop it themselves, without entering into JV arrangements. An example

---

20. Withholding tax on dividends paid to resident persons and non-resident persons is 5 per cent and 10 per cent, respectively.
21. Withholding tax on interest income is 15 per cent.
of such a fund is the Actis fund, which directly acquired 32 acres of land in Nairobi County to develop the aforementioned Garden City, currently the largest development in east and central Africa with more than 400 high-end residential units.23

For JV arrangements, a common framework is for the private equity firm and the developer to set up a new entity jointly (either a limited liability company (LLC) or a limited liability partnership (LLP)), which would acquire the land for development. Upon completion of the development, the entity will either lease the property to tenants or sell units in the development to individual or corporate buyers. One exit option available to private equity firms is to transfer the property into a REIT, which is thereafter listed at the NSE. Another exit strategy is to transfer the underlying reversionary interest in the land into a separate new company, which is wholly owned by the purchasers of the units in the development.

IV TRANSACTIONS

i Legal frameworks and deal structures

When undertaking an M&A or JV transaction relating to a real estate entity, knowledge of all the laws relating to land and land ownership in Kenya is essential. Land laws in Kenya have remained very fragmented, with over 20 different statutes governing land ownership and interests relating to land.

In 2010, Kenya promulgated a new Constitution, paving the way for an overhaul of the land law systems in Kenya. In 2012, the Kenyan legislature enacted new land laws: the Land Act,24 the Land Registration Act,25 and the National Land Commission Act.26 The new statutes repealed and made amendments to some of the old land laws such as the Indian Transfer of Property Act of 1882, the Registered Land Act27 and the Registration of Titles Act.28 That notwithstanding the new land laws failed to achieve their stated objective of fully consolidating the land laws in Kenya.

Other legal considerations depend on the intended use of the underlying asset. One needs to be familiar with all laws that govern the construction and development of real estate. Such laws include the Physical Planning Act,29 the Environmental Management and Coordination Act30 and the Land Control Act.31 These statutes set out the requisite approvals and consents for undertaking a real estate development as well as the cost and process involved. These approvals include change of user, building approvals and environmental approvals.

The parties must also understand the manner in which the development will be sold or leased to potential purchasers. Knowledge of the various land-planning structures is key, for example, benefits of sale by way of long-term leases, subdivision and use of the Sectional

23 www.act.is/our-portfolio/garden-city-retail/.
24 Act No. 6 of 2012.
25 Act No. 3 of 2012.
26 Act No. 5 of 2012.
27 Cap 300, Laws of Kenya.
28 Cap 281, Laws of Kenya.
31 Cap 300, Laws of Kenya.
Properties Act\textsuperscript{32} are important. Since most unit sales in developments are undertaken off plan prior to construction, the terms of the sale agreement between the project company and the potential unit purchasers should be properly structured and will usually include substantive provisions on the parties’ obligations.

The initial phase of a JV arrangement is the transfer of the land into the JV entity, which requires certain tax considerations. Where properly structured, the transfer of property to the JV company can enjoy stamp duty exemption (see Section IV.x, infra).

The transfer of the land into the JV company will take the form of a straight sale and purchase of property, with the landowner and the JV company executing an agreement for sale. Once completion occurs as provided for under the agreement of sale, the registration formalities are undertaken at the relevant lands registry to register the transfer of the land in favour of the JV company.

The landowner and the private equity firm would usually execute a share subscription agreement or a shareholders’ agreement (or both) to govern their relationship throughout the term of the JV arrangement.

Depending on the tax structuring, the consideration paid by the landowner (i.e., the land) and the consideration paid by the private equity firm (i.e., liquidity), the transaction can be structured as either as wholly equity or wholly debt or a combination of debt and equity transaction.

The use of LLPs instead of LLCs to undertake real estate developments is increasing. LLPs have the advantage of being transparent vehicles for the purposes of tax, while at the same time offering the partners the protection of limited liability. When the project entity is structured as an LLP, the landowner and the private equity firm will enter into a partnership deed instead of a shareholders’ agreement and instead of subscribing for shares, the parties will acquire stakes in the LLP. There are, however, certain tax benefits that accrue solely to LLCs that should be considered depending on the nature of the transaction. It is also important to note that when seeking debt funding, an LLC can issue a debenture to secure the repayment of the debt while an LLP cannot, making an LLC more attractive to potential lenders.

\section*{Acquisition agreement terms}

Structuring a JV or an M&A transaction relating to a real estate entity requires extensive due diligence to be undertaken to ascertain ownership and the authenticity of the title to the underlying asset (i.e., the land). Due to the parlous state of the records at the land registries in Kenya, as well as the documented abuse of original documents (including forgeries and multiple title allocations), due diligence on land involves more than just a title search at the lands registry. It will usually also involve engaging a surveyor to confirm the physical coordinates and attributes of the land as well as to confirm that the records at the various government agencies are valid and have been properly issued.

Due to the lengthy period of time it takes to undertake the due diligence, the transaction documents will usually provide for the due diligence process to be a condition precedent to the completion of the transaction and will allow the private equity firm to withdraw from the transaction at any time prior to completion in the event the due diligence is not satisfactory.

\textsuperscript{32} Act No. 27 of 1987.
The warranties provided by the landowner and the JV company are usually extensive and very specific to issues relating to land. Examples of some of these warranties are:

a. a warranty that the land was acquired in accordance with and in compliance with the terms of all approvals, consents, permissions and authorisations required from any government authority;
b. a warranty that the land is not subject to any overriding interest that would grant a third party non-registrable interest in the land; and
c. a warranty that there are no boundary issues relating to the land and that the description of the underlying asset is correct, and the size and other conditions relating to the land are true in all respects.

A common provision in real estate JV arrangements is that the JV company will not issue any dividends until all units in the underlying development are completely sold. This is because for the initial period during construction, the JV company is usually in a loss-making financial position and will only be in a position to issue dividends once the whole development is sold. Certain JV arrangements will allow for the issuance of some of the units in the development to the shareholders as dividends in specie.

Usually, the voting requirements will call for passing of resolutions through a majority vote except for in certain reserved matters that may call for either a vote of shareholders holding an aggregate of 75 per cent or more or a unanimous vote. One such instance is where the private equity firm that, in most instances, is the majority shareholder also has a majority stake in the entity that is undertaking the construction or project management. In such a structure, owing to the potential conflict, there will be certain reserved matters set out in the shareholders’ agreement such as the remuneration of the project manager or the extension of time on the project that would require the landowners’ consent.

Under the Competition Act, all M&A and JV arrangements in or outside Kenya that result in a change of control in an undertaking in Kenya require the approval of the Competition Authority of Kenya (CAK). A ‘change of control’ is not defined under the Competition Act, but Section 41(2) of the Competition Act provides different ways in which a merger may be achieved, which include the purchase of shares. Section 41(3) of the Competition Act defines when a person is deemed to control an undertaking. Some of the forms of control listed under Section 41(3) include beneficial ownership of more than one-half of the issued share capital of the undertaking, the ability to control a majority of the votes that may be cast at a general meeting, the ability to appoint a majority of the directors, and the ability to materially influence the policy of the undertaking.

The CAK has issued merger threshold guidelines (Threshold Guidelines), which were applicable from 1 August 2013. The effective threshold is 1 billion shillings in combined assets or turnover of the parties. The Threshold Guidelines are, however, not legally binding but provide guidance to parties on the circumstances under which a transaction may be considered for exclusion and where a full notification is required. The Threshold Guidelines, however, do not afford parties an automatic exclusion from the provisions of the Competition Act, and parties are nonetheless required to file an application to the CAK for exclusion.

---

33 Act No. 12 of 2010.
iii Hostile transactions
There do not appear to have been any hostile transactions relating to public real estate companies.

iv Financing considerations
JV and M&A transactions are funded through a mixture of both equity and debt. The equity component is usually invested at the onset when the private equity firm or other private investors are acquiring a stake in the JV entity. Real estate transactions are also largely funded through bank debt. Recently, international banks have been willing to extend debt for the development of large real estate developments; a good example of this is Standard Bank of South Africa, which has financed the development of the Garden City shopping centre. Local banks are also participating in debt financing of large-scale real estate developments such as KCB Bank’s lending to finance the Garden City residential development and Co-operative Bank lending to finance the Two Rivers development.

v Tax considerations
The following are the key taxes that apply to real estate transactions. Stamp duty is a tax charged on the transfer of land and shares, and is payable at a rate of 4 per cent of the value of the land in respect of the transfer of land situated in a municipality and 2 per cent of the value of the land outside the municipalities. On the transfer of shares, the stamp duty payable is 1 per cent of the consideration of the shares.

Sale and leasing of commercial buildings is also subject to VAT at the standard rate of 16 per cent.

Capital gains tax (CGT) was reintroduced in Kenya with effect from 1 January 2015 after having been suspended in 1985. CGT is chargeable on the whole gain that accrues to any individual or corporate body on the transfer of property (includes land and shares) situated in Kenya, at a rate of 5 per cent of the gain. This gain is determined as the excess of transfer value over the property’s adjusted cost.

vi Cross-border complications and solutions
Although there are no foreign exchange controls in Kenya, there are a number of challenges faced by real estate developers (including private equity firms) in Kenya, especially with respect to funding strategies and extraction of profits from Kenya. For foreign-owned companies, thin capitalisation restrictions limit the deductibility of interest for corporate tax purposes where the debt-to-equity ratio is greater than 3:1. In addition, interest-free loans provided by foreign shareholders are subject to deemed interest provisions that require a notional interest (based on the prevailing Treasury Bill rates) to be computed and withholding tax at the rate of 15 per cent paid to the Kenya Revenue Authority on a monthly basis.

Extraction of profits by way of dividends is subject to withholding tax at a rate of 10 per cent when paid to non-resident shareholders. In addition, ‘compensating tax’ (at a rate of up to 42.86 per cent) may be triggered where the company making the dividend payment does not have sufficient credit in its dividend tax account. In addition, Kenya has transfer pricing rules that require transactions between Kenyan entities and foreign related parties to be undertaken at arm’s length, which limits the extent to which management fees or royalties, for example, can be used to extract profits from the Kenyan entity.
There are various tax-structuring options available for real estate entities to address the challenges discussed above, including the use of quasi-equity instruments to deal with funding restrictions. It should also be noted that LLPs are tax transparent and they therefore provide a suitable vehicle for use in real estate development; however, where an LLP is wholly owned by foreign partners, there are certain tax-structuring aspects that should be considered carefully.

With regard to landownership, the Constitution provides that foreigners and corporations not wholly owned by Kenyan citizens cannot hold freehold interest in land or a leasehold interest in land for a term exceeding 99 years.

Moreover, under the current law, non-citizens are restricted from acquiring agricultural property. The Land Control Act provides, inter alia, that any sale, transfer, lease, exchange, partition, sub-division or other dealing in agricultural land or the sale, transfer, mortgage or other dealing in any share of a private company that owns agricultural land is void for all purposes unless the land control board for the area in which the land is situated has issued its consent in respect of that transaction. The Land Control Act further provides that the land control board will refuse consent in any case in which the land or share is to be disposed of by way of sale, transfer, lease, exchange or partition to a person who is not a citizen of Kenya or a private company all of whose members are Kenyan citizens. There are, however, structuring methods adopted that can enable a non-Kenyan to acquire interests in agricultural land.

A vast majority of land in Kenya is agricultural land and therefore any foreigners wishing to acquire the same, or to acquire shares in a company that owns agricultural land, would first have to obtain a change of user in respect of the land or, alternatively, adopt relatively complex structuring methods that permit the holding of shares in the landholding company by non-Kenyans.

V CORPORATE REAL ESTATE

An operating company/property company deal (opco/propco) is a strategy in which a company is divided into at least two parts:

a a property company that owns all the property, assets associated with generating revenues; and

b an operating company that uses those assets to generate revenues.

Opco/propco deals are becoming increasingly common in the Kenyan market as a result of various reasons. First, they provide flexibility on disposal or exit, as either the operating business or the property can be disposed of independently or new investors can invest at either the propco or opco level. From a tax perspective, there are various issues that should be considered before adopting an opco/propco structure. For example, there are no provisions allowing for set-off of tax losses for entities of the same group. This therefore means that in an opco/propco structure, one entity might be in a tax-paying position while the other entity has tax losses that it continues to accumulate. In addition, from a value added tax (VAT) perspective, related parties are required to transact on an arm's-length basis and, as such, the propco would be required to charge the opco rent at market rates. The VAT charged by the propco could end up being a sunk cost in some instances, as there are currently no provisions allowing for VAT groups in Kenya.
VI OUTLOOK

The outlook over the next few months is that large-scale real estate development entities will continue to attract investment from local and foreign investors, which will require complex structuring and legal documentation to specifically cater to the specific issues relating to mergers and acquisitions in the real estate sector.
Appendix 1

ABOUT THE AUTHORS

ANNE KIUNUHE
*Anjarwalla & Khanna*

Anne Kiunuhe is a partner in the corporate department at Anjarwalla & Khanna, Kenya's largest corporate law firm, and an advocate of the High Court of Kenya. With over 10 years of experience as a corporate lawyer, she specialises in mergers and acquisitions, IT and telecommunications law, competition law and intellectual property law.

Having handled a number of prominent corporate law transactions in Kenya, Ms Kiunuhe has represented multinational corporations such as Helios Investment Partners, Essar, Bharti Airtel, Schneider Electric Industries, Centum and Two Rivers Development Limited and is a recognised leader in her field. A pioneer in A&K’s growing competition law practice, she spearheaded the first joint Kenya COMESA Competition Conference, which drew leaders from the recently formed COMESA Competition Commission (CCC), the Competition Authority of Kenya (CAK) and international experts. She also represented Kenyan stakeholders at the COMESA Competition Workshop 2014.

Ms Kiunuhe is ranked by the *Chambers Global Legal Directory*, which has described her as a ‘very positive and sparky’ lawyer and receiving client praise for her drafting skills and contracts analysis. In addition, she was voted one of Kenya’s best M&A lawyers by *Best Lawyers International* and won the CfC Stanbic Rising Star Award 2015 in the professional services category.

MONA DOSHI
*Anjarwalla & Khanna*

Mona Doshi is a partner at Anjarwalla & Khanna and co-heads the firm’s real estate practice. She is based in firm's Mombasa office. She also leads the firm’s private client law department and is an advocate of the High Court of Kenya.

Ms Doshi is regularly invited to speak at international and local conferences on topics including real estate, estate planning and wealth management for high net-worth individuals in Kenya, and Islamic finance.
She was recommended by the *Legal 500* in the real estate and construction, and banking and finance sectors. She was also praised for being ‘extremely professional and diligent in her work’. Ms Doshi was singled out for individual praise and described as ‘honestly one of the main reasons for using Anjarwalla & Khanna and will be an authority in times to come’ (*IFLR1000 2016*).

**DANIEL NGUMY**  
*Anjarwalla & Khanna*  
Daniel Ngumy is a partner at Anjarwalla & Khanna and leads the firm’s tax department. He specialises in Kenyan and international tax law, and has experience in corporate and commercial legal work.

He is a qualified CPA(K) and holds a bachelor of laws degree from the University of Nairobi as well as a master of laws degree from the University of London (UCL and Queen Mary). Mr Ngumy has over 10 years’ experience collectively working for Anjarwalla & Khanna, PricewaterhouseCoopers in Nairobi and KPMG in Europe.

He provides ongoing tax advice on matters affecting clients across various industries, including in the banking, insurance, finance, agricultural, power and infrastructure industries. He also has advised on a variety of matters, from debt and equity capital transactions to mergers and acquisitions.

Mr Ngumy was ranked by *Chambers Global 2016* as a ‘notable practitioner’ in corporate and commercial.

**CAROLINE KARUGU**  
*Anjarwalla & Khanna*  
Caroline Karugu is a senior associate in the real estate and finance department at Anjarwalla & Khanna and focuses mainly on property law, property development work, real estate financing, property joint ventures and structuring of mixed use developments.

She has handled a variety of property transactions, including structuring of property joint ventures, property acquisitions, residential and mixed use projects, large scale commercial retail leasing, property management contracts and securities.
ANJARWALLA & KHANNA
The Oval, 3rd Floor
Junction of Ring Rd Parklands & Jalaram Rd
Westlands, Nairobi
Kenya
Tel: +254 203 64 0000
ak@africalegalnetwork.com
dng@africalegalnetwork.com
cnk@africalegalnetwork.com

SKA House
Dedan Kimathi Avenue
Mombasa 80100
Kenya
Tel: +254 41 231 2848
Fax: +254 41 231 2013
mkd@africalegalnetwork.com

www.africalegalnetwork.com