



Welcome

We are delighted to introduce our second issue of Built Environment Insights, our biannual publication in which we cover key topical issues for the Built Environment from around the globe. This edition examines the way in which cities are changing to respond to growing and ageing populations, evolving retail and leisure patterns and increasing social infrastructure.

We hope you find Built Environment Insights useful and enjoy reading this issue. If you have any feedback or if there are any topics that you would like us to cover in future editions, please email builtenvironmentinsights@ashurst.com



David Jones
Partner, Head of Built
Environment, EMEA
T +44 20 7859 1983
david.jones@ashurst.com



Pauline Tan
Partner, Joint Head of
Built Environment, APAC
T +61 2 9258 5638
pauline.tan@ashurst.com



Grant Rowlands
Partner, Joint Head of
Built Environment, APAC
T +613 9679 3473
grant.rowlands@ashurst.com

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Infrastructure as a catalyst for growth

by Jamie Chapman

The current number of new development opportunities being created around transport projects, and the release of land adjoining and airspace above rail infrastructure for development purposes, is unprecedented in its scale.

Transport-orientated development, particularly in London, has been a feature of the real estate development market for some time. The current number of new development opportunities being created around transport projects, and the release of land adjoining and airspace above rail infrastructure for development purposes, is unprecedented in scale. In central London the regeneration of the King's Cross/St Pancras transport hub (started by the construction of HS1) continues to roll out exciting new projects such as the Google European HQ building and will soon be closely linked to the HS2-driven Euston station campus redevelopment and possibly also Crossrail 2, the route of which is to bisect Euston and St Pancras stations

The Elizabeth Line (Crossrail 1) is nearing completion with multiple over-station developments at stations such as Tottenham Court Road, Bond Street and Farringdon becoming active or close to handover prior to the commencement of operations next year. Transport for London (TfL) is in the second year of its Property Partnerships programme which is intended to involve the

release of up to 50 development sites alongside and over their infrastructure in the next ten years.

At the same time, transport operators are looking for new ways to capture a larger slice of the value that they bring to areas with new infrastructure, and the Mayor of London has recently signed a Memorandum of Understanding with the UK Government to pilot a new Development Rights Auction Model in London.

This article will examine the different factors at play in this development boom around transport infrastructure. These factors include the changing approach of transport authorities seeking to release value from their real estate interests to help address funding costs for new infrastructure requirements, a shift in attitude towards development risk by such

authorities and developers, the need to address the lack of housing supply and the advances in engineering and construction design.

FUNDING

The UK continues to require significantly increased investment in its transport infrastructure against a backdrop of multiple competing demands on the shrinking public purse. A growing part of the funding solution is to unlock value from the development opportunities created by the construction of new infrastructure, and in particular overstation or over-site developments (OSDs).

The Crossrail project has a target to raise raising more than £0.5 billion of capital receipts from its OSDs and a significant element of the funding model proposed for Crossrail 2 harnesses development opportunities and growth in value of adjoining real estate.

While HS1 did generate good returns from development on land acquired for that project for the Department for Transport, a far larger return is expected from the regeneration proposals that are being brought forward for the HS2 project. The Euston station estate has the capacity for six million square feet of mixed-use development that will reshape the Camden area of central London. At the northern end of the first phase of HS2 in Birmingham there is already 600,000m² of new commercial. leisure and retail development under way or in the pipeline, focused around the new HS2 station at Birmingham Curzon. This could be replicated around the other main station sites at Manchester, East Midlands (Derby/ Nottingham) and Leeds.

More recently, the Government has been considering ways in which it may be able to fund future infrastructure through the capture of increased value in land created by new transport hubs. It is well understood that proximity to public transport influences property prices. For example, the Jubilee Line Extension led to land value increases of more than 50 per cent. This land value capture would allow authorities to "pull forward" the land value benefits of public transport to fund current development. At present, much of this increased land value is won directly by savvy developers who snap up nearby properties and then build accordingly. However, the Spring 2017 Budget confirmed the Government's support for a pilot land value capture scheme in London that would assist TfL in funding the infrastructure schemes, such as Crossrail 2, that the city desperately needs. This scheme, known as the Development Rights Auction Model, involves the



integrated planning and consent to land use and density in a defined zone around a new transport hub, with land that benefits from this zoning being assembled (with the agreement of landowners) and auctioned to developers. The proceeds of sale are then split between the landowners and the transport authority. Landowners who do not wish to participate in the auction can still benefit from the zoning, but with a high planning levy payable. TfL estimates that this model could double receipts for public authorities compared with the existing planning levy regime.

ATTITUDE TO DEVELOPMENT RISK

In order to take greater advantage of the returns that can be made through OSDs, the relevant transport bodies are showing a much greater willingness to partner with property developers and to share development risk and financing requirements.

For transport authorities, their role as operators of a safe and efficient transport network remains their primary duty but this is being supplemented by a secondary, yet still important, purpose of using their assets to create funding for new projects and reinvestment in improving existing infrastructure. OSDs are a very good example of this change in approach as the transport authority is accepting a long-term responsibility for supporting the new commercial developments being constructed on station boxes, and are designing their new station structures with additional loadbearing capacity to facilitate larger scale developments than have been seen in the past. Many of the Crossrail OSDs are following this model which has been factored into the station design arrangements from the outset.





This is a model that has been used successfully in other parts of the world such as the mass transit railway (MTR) in Hong Kong, which was constructed and is operated by the MTR Corporation Limited. The MTR is one of the most profitable metro systems in the world. One of the principles behind its development was the recognition that it is very difficult to provide rail services on a self-supporting basis and that in order to fund both the construction and operations it is necessary to exploit fully the property development opportunities created by the new railway. The MTR stations on the Hong Kong metro network are integrated into multi-million square feet developments of retail, hotel and residential complexes.

MTR will be involved in Crossrail as the concessionaire operating the rail service and is also part of the consortium involved in the operation of part of Sydney's expanding metro network where it is seeking to employ its value capture approach of maximising property development opportunities with network growth.

HOUSING SHORTAGES

Another increasingly important factor in development around transport hubs is the shortage of land available for housing supply. The Housing White Paper states that the Government needs to address the limited scope for high-density housing development in urban areas as part of the solution to the housing supply shortage. One of the ways identified for doing so is to facilitate this higher density development in areas well served by public transport. It is therefore anticipated that residential schemes will form a larger component of developments around rail stations. A good example of this is the 67 acre King's Cross station area, where 2.000 new residential units are being created.

The Mayor of London, Sadiq Khan, has made addressing the shortfall in new stock to meet London's housing demand one of his key priorities and has enlisted TfL's help in bringing forward land for new housing from its portfolio of more than 5,000 acres of potential development

sites Network Rail has announced that it is targeting the release of a significant number of sites throughout the UK to accommodate 12,000 new homes by 2020. HS2 has already spawned masterplan arrangements for Birmingham, which include the creation of more than 50,000 new homes by 2031. There is also an expectation that the local planning authorities will not only support higher density residential development around stations but will require a material component of any future large-scale development to provide a significant number of new housing units.

The rise in the popularity of Build to Rent housing (BTR) is expected to attract further investment into large schemes around rail hubs. BTR developments are an ideal fit for those schemes: they are often designed on a large scale, to ensure management efficiency, and work best in sites which are well connected. Equally, BTR schemes can be built much faster than conventional for-sale schemes (as flats can be let faster than they can be sold), and the institutional investors active in the BTR market are natural partners for transport undertakings given their long-term approach and strong covenants.

REGENERATION AND PLACEMAKING

The regeneration of the King's Cross and St Pancras station hub is a particularly fine example of how a once neglected urban environment that was dominated by rail infrastructure can be given a new lease of life. The restoration of the frontages of both stations, including the iconic station hotel now known as the St Pancras Grand and the modern expansion of the transport facilities, has been done very sympathetically and has been a catalyst for creating retail



destinations for both passengers and local residents within the stations and externally.

The whole area has benefitted from the placemaking approach that has been adopted with the broad public realm facilitating a large offering of restaurants and bars that are complementary to the office and residential use. This has given the area the ability to attract such prestigious corporate occupiers as Google, Louis Vuitton and AstraZeneca. It is a successful model that the team at HS2 who are looking to bring forward Euston's future redevelopment plans will wish to learn from and emulate.

London & Continental Railways' redevelopment proposals for the Leake Street arches at Waterloo station are operating on a similar basis, creating a strong sense of identity with the redevelopment of the railway arches to create a much improved retail and leisure offering in close proximity to Almacantar's redevelopment of One and Two Southbank Place, and HB Reavis's development of 1 Waterloo, leading to the Thames.

Rail operators no longer view stations as just transport hubs as they are now evolving to meet the needs of urban life. When launching the hunt for architects, developers and designers of the three new railway stations for HS2, Transport Minister, Andrew Jones, emphasised that "the winning bidders will need to ensure the stations provide the best possible customer experience". Stations are destinations in their own right for passengers and visitors alike as demonstrated by the bars and restaurants in St Pancras station, which includes the longest champagne bar in the UK.

PLANNING ISSUES

There are significant planning benefits to encouraging development around new and existing commuter hubs - reducing travel distances by private transport, making effective use of private and public sector land in sustainable locations and helping to secure the wider regeneration and growth of the local area

The Government is keen to ensure that this is recognised at local authority level. In 2015 it consulted on possible changes to National Planning Policy to include an expectation on local planning authorities to "..require higher density development around

commuter hubs wherever feasible", with the aim of boosting new development and regeneration in "sustainable locations" and so reduce travel by private transport. The Housing White Paper again emphasises increased density around transport hubs.

Furthermore, in 2016, as part of its commitment to increase housing supply, the Government called for 20 councils to set out ambitious proposals for taking forward development opportunities around stations and offered assistance from Network Rail and the Homes and Communities Agency. Pilots have already been launched in York, Taunton and Swindon. The Neighbourhood Planning Act 2017 has recently recognised the need for wider compulsory purchase powers to facilitate regeneration around transport hubs. As a result, both the Greater London Authority and TfL now have the powers to compulsorily assemble the land needed for both transport infrastructure and the wider resulting development opportunity through a single compulsory purchase order.

Of course, development over rail infrastructure comes with its own

drawbacks for the planning authority. The standard design response of servicing a building through a basement car park will not normally be possible. Innovative solutions are needed to ensure that development essentials such as cycle spaces, plant and service access do not compromise the need for active ground floor frontages and high quality building design.

CONSTRUCTION/ENGINEERING ADVANCES

The safety of the existing rail operations will remain the paramount concern of the transport authority around whose station or infrastructure any development is taking place. Anyone connected with such developments will be familiar with the asset protection arrangements used by transport authorities to mitigate risk and safeguard the rail operations. Allied with this, the provision of adequate security (collateral warranties, insurances (including non-damage and non-negligence), bonds and guarantees) helps further reduce risks and exposure for all concerned. The market position on these

requirements is fairly settled and accepted by those who regularly work with transport authorities, although the precise nature and extent of the development will be a relevant factor in determining what is required.

A settled landscape for contractual risk mitigation, while of course helpful, only goes so far. Advances in building design, engineering capabilities and construction management have also meant issues that have perhaps caused concern for developers in the past when developing in and around a rail environment do not create insurmountable problems.

Railways by their very nature have issues with noise, vibration, ventilation and heat extraction as well as other concerns. Where stations include Victorian infrastructure, there may not even be comprehensive registers of the infrastructure on a site. The benefit of creating new infrastructure or upgrading old infrastructure and integrating the design of such works with the design of new commercial developments (whether OSDs or alongside the rail works) is that

issues can be anticipated and worked around with integrated design solutions.

Early and continued communication between design and engineering teams is an effective tool to deal with most issues. Careful planning of phases of works between infrastructure operators and development management teams can also allow complicated development works to progress while busy stations are kept open and operating to almost full capacity. The development of the Shard was achieved on the site of London Bridge, one of London's busiest stations. The continued use of Euston during the HS2 works and the proposed major redevelopment will have to address similar challenges, but they are no longer seen as being impediments to successful redevelopment.

CONCLUSION

It is clear that the proliferation of developments around new and existing rail infrastructure will continue for many years. Transport authorities will need to capture value from development projects to help fund the increasing burden of new infrastructure requirements. Planning authorities will encourage such sustainable growth to make efficient use of the infrastructure and to help address the increasing demand for new residential projects. New transport links, improved urban realm and stations evolving as retail and leisure destinations will encourage more developers to seek new development opportunities around transport hubs and provide a welcome regeneration of these formerly tired urban sites.





Jamie Chapman Partner T +44 20 7859 1952 jamiegchapman@ashurst.com



The fallout from Brexit

by Nicolas Deuerling

Last year's surprising outcome of the UK's EU referendum and the looming exit negotiations are affecting both the economy and the real estate sector, not only in the UK but in the rest of Europe as well.

This short analysis focuses on the fallout from this historic decision on the German commercial real estate market as a safe haven and how this has affected investment decisions. It comprises an overview of the status quo and a short-term analysis of the impact of Brexit and concludes with an overview of four of Germany's most exciting cities for investors.

STATUS QUO

Before the referendum date was announced in February 2016, the German commercial real estate market was solid, yet far behind the UK's, with an overall investment volume of EUR 64 billion in Germany compared to EUR 91 billion in the UK between Q4 2014 and Q3 2015.1

Following the announcement of the referendum, the investment volume dropped in both countries for the same period between 2015 and 2016. However, while the UK market dropped by 37.9 per cent to a wavering EUR 66 billion, Germany's market only fell by 18.5 per cent to EUR 54 billion.² This implies that even before the Brexit referendum held on 23 June 2016, the German real estate market had nearly caught up with the UK market. The drop in investments in Germany can be

explained, at least in part, by the fact that prime locations are so sought after that there is hardly any availability on the market. Due to the current political and legal uncertainties resulting from Brexit, investing outside the UK will become increasingly attractive as long as reservations continue. In this climate, Germany is considered a safe haven by many international investors, who generally seem, in the current global political and economic uncertainty, to favour a slow but stable increase in yield.

What makes Germany a safe haven is the fact that it has solid fundamentals with a 1.9 per cent GDP growth, an unemployment rate of 5.9 per cent and a robust debt to GDP ratio of 68.3 per cent.³ In addition, interest rates for financing investments are at an all-time low. This benefits Retail Space Properties, as they correlate with the purchasing power of the population. Furthermore, the

political environment in Germany is stable. There are no indications of a drastic shift in politics in the foreseeable future, with the current governing party winning the three most recent state elections and the contending party candidate being a former President of the European Parliament. The recent outcomes of the Dutch and French elections will result in a further increase in stability, as Germany is arguably the country which profits most from a strong EU.

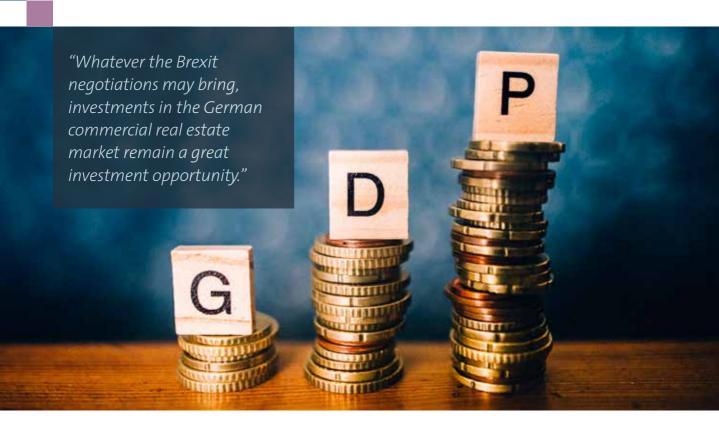
As such, the German real estate market slightly overtook the UK market in the first quarter of 2017, with an overall volume of EUR 12.65 billion⁴ compared to EUR 12.54 billion.⁵ This is supported not least by the fact that Germany is strongly diverse in its property markets, with its top seven cities (Berlin, Hamburg, Munich, Cologne, Frankfurt, Düsseldorf and Stuttgart) constituting 55 per cent of the total transaction volume in 2016.⁶

Therefore, it is easier for investors to diversify their investments within Germany towards multiple cities, further reducing their risk. In particular, the office-space market seems to be of interest to investors, with a transaction volume of EUR 4.9 billion compared to the UK's EUR 4.6 billion.⁷

In addition, investors who have to follow an EU quota as a self-imposed investment requirement will have to shift some of their investments from the UK to the EU to remain compliant with that quota. This is supported by the fact that Openended Real Estate Funds/Special Funds and Asset/Fund Managers are responsible for 57 per cent of total purchases with a percentage increase in international buyers of 48 per cent to a total of 43 per cent of all transactions in the first quarter of 2017 in Germany.8

In principle, business activities in Germany are free from regulations, as German law generally makes no distinction between Germans and foreign nationals regarding investments. Unlike in other markets, financial barriers such as restrictions on capital accounts or legal barriers such as differences in taxation or access to ownership of foreign assets do not exist in Germany. Supported by a strong and reliable legal system, restrictions are only allowed for reasons of foreign policy, foreign exchange, or national security. However, in practice, such restrictions are seldom imposed. There is no broad authority to review foreign real estate investments, and privatisation programmes for foreigners are non-existent. On the contrary, if the paperwork is drafted in the right way, foreign investments into German real estate can benefit from considerable tax incentives. For instance, instead of investing in a German limited liability company ("Gesellschaft mit beschränkter Haftung - GmbH") owning a





property, investors can purchase it through a foreign investment vehicle. Since the foreign investment vehicle does not form a permanent establishment in Germany it is not subject to German trade taxes, which range from 7 per cent to approx. 17 per cent. The GmbH, however, is subject to trade taxes and can only achieve an exemption under harsh conditions.

SHORT-TERM EFFECTS

It is still too early to see what the full impact of Brexit will be on the commercial real estate market, both in the UK and in Germany. This will depend largely on the details of the Brexit agreement, which is currently being negotiated between the UK and the EU.

In case of a "hard Brexit" the UK would give up its participation in the EU single market along with its submission to EU legislation and to the jurisdiction of the European Court of Justice. This would require the UK to carry out trade with

Europe and other nations under the World Trade Organization rules. By contrast, a "soft Brexit" is interpreted as any number of possible arrangements that might be negotiated with the EU and that represent anything less than a full withdrawal. How such a deal is going to look will be determined by the ongoing negotiations which will last until March 2019, when the UK is scheduled to leave the EU. While Theresa May has ruled out the possibility that the UK will remain in the single market, the outcome of the 8 June general election, (which resulted in a hung parliament and May losing her majority,) may have put a sharp brake on her plans, as the loss of the Tory majority in parliament is a strong indication that a mandate for a hard Brexit is off the table. Officially, May is set to maintain the present course; however she is under enormous pressure from outside her own party and within to soften her stance. Currently she

seems to retain her popularity but experts are uncertain whether, and for how much longer, she is able to hold her supporters together. In any case, this has resulted in further uncertainty for the UK market. Twelve months after the EU referendum, British politics is in chaos again, and the consequences for the Brexit negotiations are currently unforeseeable.

Independent of the exact details of Brexit, there are consequences which are certain. EU institutions currently residing in the UK such as the European Medicines Agency and, more importantly, the European Banking Authority will move to an EU member state. Currently, two main contenders have emerged as the latter's new host. Frankfurt and Paris. In the case of a move to Frankfurt, the idea to merge with the European Insurance and Occupational Pensions Authority to create an agency with the purpose of regulating both insurance and banking activities seems reasonable.

This would further strengthen Frankfurt as the financial hub of the EU since it is already home to the European Central Bank.

Along with the UK leaving the single market comes the loss of EU passporting rights. The EU passport provides a legal mechanism that permits financial services companies based and regulated in one country of the EU, and authorised under one of the EU's single market directives, to do business in other member states purely on the basis of their home state authorisation. This affects many companies in the financial sector which cannot afford uncertainty as they have to plan several years ahead.

It remains to be seen how big financial players will react to a

potential loss of passporting rights. This could have a substantial influence on the German commercial real estate market. However, it is currently unclear whether financial institutions will relocate in bulk, whether they will merely open small subsidiaries in Germany, or whether they will move to other major European cities, such as Paris, Amsterdam and Dublin.

IMPACT ON CITIES, NOT COUNTRIES

While Brexit certainly influences the German commercial real estate market as a whole, its impact is heavily concentrated around the major urban hubs. Similarly, current market opportunities are now more about cities rather than whole countries. Unlike the UK, where the majority of commercial headquarters are located in London, Germany has multiple headquarter locations, and its seven biggest cities host a wide variety of businesses lines. While Frankfurt is the financial centre of Germany, Düsseldorf is home to numerous companies in the fashion and beauty industry, and Berlin is the new "start-up haven" of Europe.

Although all seven big cities in Germany seem to profit from post-Brexit insecurity, four cities stand out in particular. Berlin, Hamburg, Frankfurt and Munich have been ranked first, second, third and fifth respectively in a recent study. 9

While the average rental price in the major German cities has remained relatively stable, it is



nowhere near the average rents paid in London or Paris This means there is tremendous potential for rent to increase in the coming years.

Berlin

Ranked first, Berlin is on its way to becoming a truly global city - young, fashionable and full of opportunities. It hosts numerous start-ups, with more than 40,000 companies founded in 2016 alone. With a harder stance on immigration as a likely consequence of Brexit, and the resulting difficulty in sourcing a wide range of skilled staff in the UK, many US and Asian businesses may choose Berlin as their new base of operations in Europe. This could be especially true for Fintechs, which are already represented quite prominently in the city, as they would profit from financial services passporting in Germany.

With an office vacancy rate of 4.1 per cent,10 the market is already stretched and in need of new investments

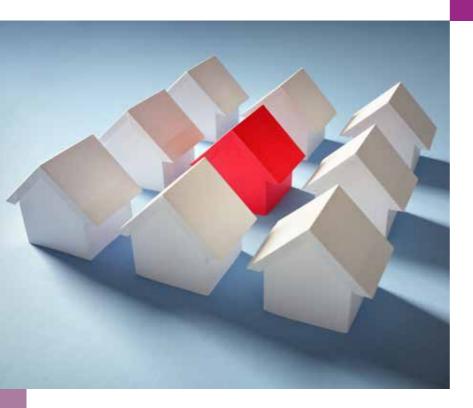
Hamburg

While Hamburg, unlike Berlin and Frankfurt, might not profit from Brexit directly, its high sustainability makes it ideal for established, non-financial companies from the US and Asia considering relocation to Germany. Regularly voted as one of the most liveable cities in the world, it has serious power to

attract qualified employees who **FOOTNOTES**

- 1. PWC Emerging Trends in Real Estate New market realities Europe 2016, p7
- 2. PWC Emerging Trends in Real Estate New market realities Europe 2017, p17
- 3. Knight Frank The Germany Report 2017, p3
- 4. BNP Paribas Real Estate Investmentmarkt Deutschland Q1 2017, p1
- 5. CoStar Investment Review 04 May 2017
- 6. Knight Frank The Germany Report 2017, p5
- 7. Catella European Office Market Map 2017
- 8. Colliers International Investment Germany Q1 2017
- 9. PWC Emerging Trends in Real Estate New market realities Europe 2017, p30
- 10. Knight Frank The Germany Report 2017, p7
- 11. DG Hyp Real Estate Market Germany 2016 / 2017, p32
- 12. Frankfurter Allgemeine Zeitung Frankfurt hat im Brexit Rennen die Nase vorn, 19 July 2017
- 13. Knight Frank The Germany Report 2017, p8
- 14 Ibid, p11
- 15 Ibid, p11





might be deterred by the post-Brexit immigration policies of the UK.

Hamburg offers a diverse economy with a strong manufacturing industry on the one hand and an innovative media, life science and information technology sector on the other. With a vacancy rate of 5.8 per cent, Hamburg has potential for additional investments in the commercial real estate market."

Frankfurt

Frankfurt could be one of the big post-Brexit winners. As the home of over 230 national and international banking institutions, and home of the European Central Bank, it would be only natural for the European Banking Authority to follow suit. This could tip the scales in favour of Frankfurt as the next financial capital of the EU. In addition, the Federal Financial Supervisory Authority of Germany is located in Frankfurt. This would have the advantage of short distances for those institutions that are

considering settling in Frankfurt for passporting purposes.

So far, UBS has announced that it will be moving 1,700 jobs to Frankfurt. Goldman Sachs has concrete plans to move another 1,000 jobs to its Frankfurt office.

Other financial institutions such as Deutsche Bank (4,000 job moves reported), JP Morgan (4,000 job moves reported), Citigroup and Credit Suisse are considering relocating at least some of their staff to Frankfurt. In total, experts expect 10,000 additional jobs over the next five years will be available in Frankfurt as a direct result of Brexit.¹²

While most Fintech start-ups are likely to favour Berlin, it is to be expected that a number of auxiliary services such as law firms (of which large numbers are already present) or asset managers will relocate staff to Frankfurt. Depending on how many jobs in financial services will be moved in the end, the commercial real estate market could expand drastically.

While the office vacancy rate of 9.1 per cent is high compared to the other top cities, this percentage is the lowest in over a decade.¹³

Munich

Munich is Germany's economic powerhouse. Almost 10 per cent of Germany's largest companies are headquartered in Munich, with 30,000 jobs created each year and an unemployment rate of 2.6 per cent – the lowest in Germany. As Germany's hotspot for information and telecommunication technologies, as well as insurance companies, Munich is likely to attract companies from both within and outside the EU.14

While its office market is the largest in Germany at over 22 million square metres, it boasts the lowest vacancy rate at 3.1 per cent.¹⁵

CONCLUSION

Although the total investment volume of the German commercial real estate market decreased after the Brexit vote, it seems to have benefitted from the uncertainty as a safe haven for investments in the short term. Long-term effects, however, are still quite unpredictable. Whatever the Brexit negotiations may bring, the German commercial real estate market remains a great investment opportunity. As the driving force of the European economy, Germany offers unmatched security coupled with competitive yields. While the search for investments in prime locations can be difficult due to unavailability of suitable properties, many opportunities can still be found in second- and third- rate locations, where there is sufficient room for prime-yield investments.



Nicolas Deuerling Partner T +49 69 97 11 27 21 nicolas.deuerling@ashurst.com



Improving standards on site

by Sadia McEvoy

Health and safety in the construction industry is under intense scrutiny. The Grenfell Tower tragedy in London brought the safety of completed buildings to the forefront, but there have also been a number of recent developments concerning the health and safety of construction workers on site.

While Grenfell has prompted a comprehensive review of the standards required of completed buildings, the industry has already seen a number of recent changes affecting the safety of the construction site itself, and of the men and women working within the sector.

With the introduction of new sentencing guidelines for health and safety offences, the Construction (Design and Management) Regulations 2015 (CDM 2015), and the Modern Slavery Act 2015, the legal framework in England has

undergone significant change in the last two years that reflects not only ongoing efforts to advance the industry's safety record but also to improve conditions for those involved in it. Client accountability is a notable feature of these developments, as evidenced by the emphasis on proportionate fines for health and safety offences, increased responsibility under CDM 2015, and transparency requirements under the Modern Slavery Act. While much is positive, many in the construction business believe there is still more to be done

SENTENCING REGULATIONS

Those in the industry will be familiar with the new sentencing guideline, effective since 1 February 2016, for health and safety and corporate manslaughter offences (the Guideline).¹ In the period since the introduction of the new regime, the impact on the construction sector has been dramatic. Already a costly sector for health and safety offences, in 2016 fines were more than double the figure of the previous year, rising to almost £14 million from £6.6 million in 2015.

Under the Guideline, courts now consider culpability, seriousness and likelihood of harm and the size of a business and its turnover when imposing fines. Fines for businesses with a turnover in excess of £50 million can now reach beyond £10 million for health and safety offences, and corporate manslaughter fines could be more than £20 million.

A recent Court of Appeal decision, *R - v - Tata Steel UK Ltd*, demonstrates the approach the courts will take towards big businesses, in particular, when it comes to the sentencing requirement that "the fine must be sufficiently substantial to have a real economic impact which will bring home to both management and shareholders the need to comply with health and safety legislation". ²

This was a case involving two incidents where Tata employees suffered severe hand injuries while using machinery. When calculating the fine, the judge in the Crown Court, at first instance, had to take into consideration Tata's status as a "very large organisation" with

a turnover of some £4 billion; however, the Guideline only provides guidance on fine levels for "large" organisations with much smaller turnover. This made the judge's function more challenging in terms of imposing a fine that would have "a real economic impact". But the judge found a way of achieving a suitable level of fine by elevating the "harm category" of the offences.

In its observations on the sentence at first instance, the Court of Appeal noted that the resultant fine was out of proportion to penalties imposed in the past but the Guideline had, in the words of the Crown Court judge, "marked a new dawn". The calculation of the fine was heavily dependent upon turnover and organisations potentially affected by the Guideline "had better wake up to this fact".

In reviewing the case, the Court of Appeal disagreed with the Crown Court judge in relation to the categorisation of one of the offences, and consequently Tata's fine in respect of that offence was reduced (to £1.3 million from £1.8 million), but endorsed his approach towards achieving a proportionate fine.

As noted in the judgment, the Guideline marks a new dawn in terms of health and safety offences. The emphasis on economic impact, and not just on the severity of the offence, means that it is not only small contractors that need to be concerned. The Guideline does not rule out the possibility of a fine so severe that it would have the effect of putting the offending company out of business; however, this is only likely to be an acceptable

consequence if the offence is so bad that the courts feel it is warranted to prevent further injuries or offences. In other instances, the Guideline allows for a downward adjustment if financial circumstances warrant it (for example, if the business is loss-making) and gives the courts flexibility to allow time for payment or to order payment by instalment.

CDM

The primary regulatory vehicle for the management of health, safety and welfare, when carrying out construction projects, is CDM 2015. Breach of the regulations is a criminal offence by virtue of section 33(1)(c) of the Health and Safety at Work Act 1974 and the Guideline will apply when determining the sentence. CDM 2015 replaced CDM 2007 in April 2015. The earlier version was considered to be overly bureaucratic and costly to administer. CDM 2015 is intended to be simpler to use and streamlined. It applies to almost all building and construction work, including new builds, demolition works, refurbishment, extensions, conversions, repair and maintenance.

One of the most striking changes in CDM 2015 was the increased responsibilities imposed on the client who must now take a more proactive and involved role from the beginning to the end of the project. While it is the client's responsibility to appoint others with health and safety duties, such as the "principal designer", whose role includes embedding health and safety in the evolution of the project from inception and ensuring that all designers comply with their duties under CDM 2015, ultimate responsibility for any breach of duty may well rest with the client, who has an overarching duty to make suitable arrangements for managing a project, including the allocation of

FOOTNOTES

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- 2 [2017] EWCA Crim 704.
- 3 "Mental Health issues account for third of industry's absences", Construction News, 16 May 2017.
- 4 We looked at exciting technological innovation in the last edition of Built Environment.
- 5 "Modern Slavery: The Dark Side of Construction", Chris Blythe, Chief Executive CIOB, July 2015.

sufficient time and other resources. The Health and Safety Executive (HSE) specifies, for example, that "suitable arrangements" include a duty to make sure designers and contractors have the skills, knowledge, experience and organisational capability to manage the project's health and safety risks.

We have seen from the previous section of this article that fines have dramatically increased since the introduction of the new Guideline. Although clients have always been potentially criminally liable, in reality contractors were more likely HSE targets. This is expected to change, with clients more often pursued for not fulfilling their duties under CDM 2015; for example, by failing to take steps to check contractors are fit to undertake a contract safely. While some in the industry perceive CDM 2015 as onerous and unwelcome, others have responded positively, seeing it as an opportunity to overhaul their health and safety practices in a proactive and collaborative way.

HEALTH

The HSE has reported that the year to March 2017 saw the lowest number of construction work-related fatalities on record. This is encouraging news. However, there is a growing awareness that although the industry is proactive when it comes to the "safety" element of "health and safety", the "health" element has not received the attention it needs.

It is well known that construction is one of the most dangerous sectors in which to work, but what is often left unsaid is the prevalence of illness. According to the HSE, statistics reveal that construction workers have a high risk of developing diseases from a number of industry-related issues. Occupational cancer is more

common in construction than any other industry sector, accounting for over 40 per cent of occupational cancer deaths and cancer registrations. The most significant cause is asbestos (70 per cent). Other causes include silica, paint and diesel engine exhaust emissions. Inhalation of hazardous substances can also cause other health problems including breathing difficulties, lung disease and dermatitis.

Physical health risks are prevalent within the industry. Back injuries and upper limb disorders are common. Manual handling and repetitive work are frequently the cause. Noise levels can also lead to disorders, such as hearing loss, and ringing in the ears. Regular use of vibrating handheld power tools and machinery can result in a number of conditions, including HAVS (hand-arm vibration syndrome).

Mental health is topical at the moment in society more broadly. This is opportune for the construction industry, which has seen an increasing awareness of the risks associated with poor mental health. Recent research carried out by Construction News, a leading UK industry publication, into mental health in the sector revealed that one in four construction workers had considered suicide, and that 55 per cent of participants in their research have experienced mental health issues.3 Construction News has launched a campaign, "Mind Matters", to raise awareness of mental health in construction and break down the stigma surrounding mental wellbeing within what remains a male-dominated industry. According to some industry insiders, a "macho ethos" is ingrained in the fabric of the business, creating a challenging





environment in which to talk about issues such as stress and anxiety.

In the current political climate, with its greater focus on compassion and corporate accountability, we are likely to see occupational health continue to feature as an area for further improvement.

MODERN SLAVERY

At the risk of depicting the construction sector as a particularly bleak place to work, it must nevertheless be acknowledged that it is an industry that is also susceptible to modern slavery. As one commentator put it, the public face of the global construction business is all about creating inspirational buildings and pushing the boundaries of architecture and technology.4 The dark side is the systematic exploitation of millions of vulnerable migrants. This is not just a problem in less-developed nations. In the UK officials report illegal abuse of vulnerable labour, for example, by acceptance of obviously

forged documents, payment of lower wages, and requirements for labourers to work unreasonable hours or to live in unsanitary conditions. And, of course, these issues leave aside exploitation and abuse that may be taking place within the global supply chain of UK players in the industry.

Section 54 of the Modern Slavery Act 2015, which came into force in October 2015, attempts to address the problem by imposing a transparency requirement on businesses to show that modern slavery is not taking place in their company or their supply chain. While this was a worthwhile starting point, the legislation has been criticised - not least by the Government's Joint Committee on Human Rights - for not going far enough. In particular, because the Government does not police the publication of statements, and because the legal sanctions for noncompliance are limited in the first instance to an injunction compelling the organisation to report.

A Private Members' Bill was introduced in the House of Lords to strengthen and broaden the application of transparency in supply chains, but was dropped earlier this vear. In the meantime, there has been a shift in momentum towards those in the industry itself. Earlier this year, a best practice toolkit was launched by The Chartered Institute of Building (CIOB) in conjunction with industry alliance Stronger Together, to help construction businesses shape their response as they tackle modern slavery. Furthermore, a coalition of leading construction sector institutions and associations, including the Building Research Establishment (BRE) and the British Standards Institution (BSI), has formed to raise awareness and eradicate modern slavery in construction supply chains. There are a number of other initiatives, including the BRE's "Ethical Labour Sourcing Standard," which provides a framework for verifying ethical labour sourcing.

A "NEW DAWN"?

The issues currently facing the UK construction industry are significant, not only in terms of economic uncertainty, Brexit and technological change, but also safety and human welfare. As this article has shown, while to some extent it has been forced upon the sector by legislation, there is also evidence of an increasingly proactive and collaborative approach within the industry itself towards what are undoubtedly critically important subjects. With health and lives at stake, every step in this direction is to be welcomed.



Sadia McEvoy Expertise Lawyer T +44 20 7859 2017 sadia.mcevoy@ashurst.com



Improving air quality

by Eleanor Reeves, Lucy Thomas and Elle Hansen

Poor air quality can affect our health, wellbeing and quality of life. It is influencing investment decisions as the issue becomes increasingly more high profile and countries, sectors and organisations take action. On 17 May 2017 Ashurst hosted the "Breathe Easy – Practical Steps in Improving Air Quality" event in partnership with FuturePlanet, the British Property Federation and the Social Stock Exchange. Bringing together property owners, developers and entrepreneurs, the event focused on how to encourage collaboration in the Built Environment sector to improve urban air quality.

TOXIC AIR

Air pollution levels in the UK have been described as "a public health

emergency" in a report published by the Environment, Food and Rural Affairs select committee.1 Longterm exposure to nitrogen dioxide may affect lung function and cause respiratory symptoms. The annual mortality rate in the UK from exposure to outdoor air pollution has been estimated to be equivalent to around 40,000 deaths² and exposure also reduces average life expectancy.3 Outdoor air pollution can have a significant impact on indoor air quality, especially in highly ventilated buildings and buildings situated near to pollution sources. A

number of the world's largest cities (including Paris, Madrid, Athens and Mexico City) have committed to banning diesel vehicles by 2025 and in London an Ultra-Low Emissions Zone will be introduced in September 2020.

The UK Government has been taken to court over its failure to comply with EU air quality standards. The Air Quality Directive 2008 required member states, by 2010, to meet certain legally binding standards for air quality, including in relation to nitrogen dioxide. The Secretary of State for the Environment, Food and Rural Affairs was required to prepare and implement an air quality action plan with the aim of achieving compliance and reducing exposure throughout the UK by "the soonest date possible". Environmental lawyers ClientEarth successfully challenged the UK Government on its ongoing failure to achieve compliance, and in 2015 the Supreme Court ordered ministers to draw up a plan to bring air pollution within

legal limits as soon as possible. ClientEarth took the Government back to court in 2016. In 2016,⁴ the court found the Government's plans to be inadequate. Ministers were given until 24 April 2017 to draw up a new draft plan.⁵

Just before the deadline, the Government made an application to delay the publication of the plan until after the May 2017 general election. The High Court ruled that purdah was not a principle of law, and the exceptional circumstances of the threat to public health meant purdah rules could be overridden.6 The Government then published its draft plan on 5 May 2017 with a consultation period which ran until 15 June. The draft plan was criticised for failing to address non-road traffic emission sources, such as buildings and construction activities.

In July 2017 the Government published a final version of the action plan, which has again been criticised for lacking urgency and merely constituting "a plan for further plans". While the Government set out its intention for the sale of new petrol or diesel engine cars to be banned from 2040, the plan follows previous formats by requiring local authorities to provide plans for Westminster to approve. ClientEarth has not ruled out challenging the new plan.⁷

SMART CITIES

Outside of court, the good news is that there are a number of impressive and marketable innovations being deployed globally across the Built Environment sector to address air quality and help make our cities more pleasant places to live and work. We have selected some examples to illustrate the fascinating developments in this space to reflect discussions at the Breathe Easy event.

London's Air Quality Hub

The New West End Company (NWEC), together with its members, aims to improve air quality and make London's West End a more enjoyable place to work and visit. Its new business assessment tool shows businesses what steps can be taken to improve air quality, from waste to construction. For example, NWEC advice includes asking architects to design to BREEAM standards and installing 'green infrastructure'.

NWEC is also teaming up with a number of businesses to pilot an experiment on Bird Street, Mayfair to transform the space into the smartest street in the world by introducing:

 Pavegen tiles, which turn the kinetic energy produced by visitors' footsteps into off-grid energy that can either then be stored or used to power nearby electronics instantly. Pavegen tiles have also been installed at Westfield's Stratford City shopping centre;



- In partnership with BT, LinkUK kiosks will provide free Wi-Fi and wayfinding services. The kiosks have been successful in New York City, with more than 35 million sessions logged, according to the Estates Gazette;
- Gas phase advance oxidation units provided and run by Piccadillybased start-up Airlabs, which draw in exhaust fume particles together with other pollutants and expel fresh air; and
- Street furniture which will be coated with Airlite paint, a substance that reduces air pollutants and bacteria and reduces energy consumption.

Rome and Tokyo: Clean Concrete

Air-cleaning technology is also being developed in various forms around the world; another example is concrete containing photocatalysts. Photocatalysts mixed with concrete can be used to create self-cleaning structures that absorb and

FOOTNOTES

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- Royal College of Physicians, 23rd February 2016 Report, Every breath we take: the lifelong impact of air pollution
- 3. Understanding the Health impacts of Air pollution in London, published by King's College London on 14th July 2015
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- 7. "Does the UK plan to tackle air pollution stack up?", Financial Times 26 July 2017
- 8. "The Cool Innovations Improving Urban Air Quality", Huffington Post, 14 June 2017
- 9. Global Outlook, Grosvenor's research perspective on world real estate markets, May 2017
- "Developer takes a linear approach to a project in Miami as walkable locations show increased pricing",
 Wall Street Journal, 30 June 2015

neutralise pollutants. This compound has been used in Richard Meier's design of the Jubilee Church in Rome, and in paving slabs in Tokyo. It also has potential for use in the future construction of roads.⁸

European Living Walls, Green Roofs, and CityTrees

Green infrastructure, such as living walls and planted roofs which filter pollutants out of the air, is another example of development-led innovation:

- Arup and Grosvenor have trialled a living wall scaffolding system, 'Living Wall Lite'. The temporary wall was designed by Arup and manufactured by Swedish living wall specialist, Green Fortune. It was fitted with sensors to monitor its impact on noise, temperature and air pollution with the aim of reducing localised air pollution by up to 20 per cent and dampening noise pollution by 10 decibels.
- German start-up, Green City Solutions, has created 'CityTrees' by





using high efficiency mosses and lichens which are attached to air vents to accelerate the cleansing process.

At its Woodberry Down
 Development, Berkeley Homes
 in partnership with the Green
 Roof Consultancy, has provided
 enhancements for biodiversity
 and green infrastructure, such
 as installing green roofs and
 sustainable drainage systems.

Milan and Nanjing: Vertical Forests and Forest Cities

Milan is home to the Bosco Verticale ('Vertical Forest') whose balconies feature over 700 specially cultivated trees, 11,000 plants and 5,000 shrubs. The aim is for the greenery to absorb dust, produce oxygen and absorb CO2

Stefano Boeri, the architect of the Vertical Forest, has taken his idea to China where in Nanjing two towers are currently under construction. He is also planning a series of 'Forest Cities' in China, the first of which will be located in Liuzhou, and a second in Shijiazhuang.

Rotterdam's "Smog-Free" Towers

Air purification is another way in which developers and designers are looking to clean up air in urban environments. Possibly one of the most innovative examples is the "smog-free tower" created by Studio Roosegaarde, a Dutch design company. The tower draws in pollution and expels cleaned air. Some of the extracted pollution is turned into jewellery. The designers claim that one of these towers could clean 3.5 million cubic metres of air per day.

American Apps

A number of countries are also experimenting with data collection

and apps to monitor air quality. For example, the Environmental Defense Fund and Google Earth Outreach have formed a mobile measurement team to assess air pollution and identify potential contributors to poor air quality in the US. Apps are also being developed to enable users to check air quality. The app aims to help users make decisions about when and where to go outdoors, in a similar way to weather forecasts.

AIR FRESH FUTURE

There is a growing trend towards higher-density urban neighbourhoods with workplaces that are either walkable or within cycling distance. According to the data firm Real Capital Analytics, the price of commercial properties in easily walkable locations shows significantly greater appreciation trends than in car-dependent locations. The value of properties in areas less dependent on cars has risen 125 per cent over the past ten years.9 The data reflects the premium in rents paid by tenants and the increasing demand from investors who recognise the longterm value of walkability.10

Poor air quality can affect our health, wellbeing and quality of life. It is also influencing investment decisions as the issue becomes more high profile and countries, sectors and organisations take action. As the value proposition to make our urban spaces more pleasant places to live and work gains greater momentum, the Built Environment sector is taking a leading role in the deployment of innovative and marketable solutions. There is, however, still much more to be done to breathe easy.



Lucy ThomasPartner
T +44 20 7859 1305
lucy.thomas@ashurst.com



Eleanor Reeves Counsel T +44 20 7859 1210 eleanor.reeves@ashurst.com



Elle Hansen Trainee Solicitor T +44 20 7859 3910 elle.hansen@ashurst.com



Tackling housing affordability and increasing infrastructure contribution

by Barbara Phair and Struan Davidson

With affordable housing increasingly out of reach for entrants to the Australian housing market, a number of State governments in Australia have recently introduced a range of new taxes on foreign investment in Australian residential property.

In a booming residential property market, with strong foreign investment, Australian State governments have followed the lead of other countries to introduce additional real estate transaction taxes in the form of foreign purchasers' duty and land tax surcharges. These measures are designed to tackle housing affordability and increase the contribution made by foreigners to local infrastructure, as well as also having the potential to impact local development projects and investment where there is an

element of foreign ownership.

With affordable housing increasingly out of reach for entrants to the Australian housing market, a number of State governments in Australia have recently introduced a range of new taxes on foreign investment in Australian residential property.

There have also been moves to impose additional taxes on residential property that is left vacant. These additional charges are not restricted to foreign nationals buying into the Australian residential market, but apply also to developers

and other investors who purchase and hold Australian real property for the purposes of redevelopment.

A CURB ON RISING PRICES?

Recently released government data indicates that 11 per cent of all residential purchases in the State of New South Wales are made by foreign purchasers (almost a third of which are Chinese nationals), in an environment where home prices in Sydney have risen by approximately 18 per cent in the past 12 months.

Following the lead of other jurisdictions, such as Singapore, Hong Kong and British Columbia, five of the eight States and Territories of Australia have introduced, or announced the introduction of, additional transfer taxes aimed at foreign purchasers of residential land.

up to AU\$2 billion in additional tax revenue in the next four years, which will be directed towards assisting first-home buyers by way of stamp duty concessions.

At the same time, the Federal Government has announced generous concessions to encourage investment in affordable housing projects ("build to rent") through managed investment trusts and these trusts where they are regarded as "foreign" will be subject to the State surcharges.

The jury is still out as to the likely combined impact of these measures on housing affordability. However, the fact that the foreign surcharges extend to purchases by foreign-controlled developers, as well as investments by foreign-controlled funds and corporations, means that

of the duty varies between States, but is generally about 5.5 per cent of the GST inclusive purchase price.

Whether known as "Surcharge Purchaser Duty" in New South Wales, "Additional Foreign Acquirer Duty" in Queensland, "Foreign Purchaser Additional Duty" in Victoria or "Foreign Purchaser Duty Surcharge" in South Australia (as proposed), the surcharge imposes additional duty on the transfer of residential property to "foreign persons", on top of the existing duty. The duty is not limited to the transfer of fee simple interests in land but extends also to other transactions affecting interests in land, such as the transfer of a lease at a premium if the transferee is a foreign person.

A foreign person includes a foreign individual, a foreign corporation or the trustee of a foreign trust. In New South Wales, a foreign person also includes a foreign government. The tests are complex, and vary between States, but a corporation or a trust can be treated as "foreign" under the New South Wales rules, for example, if a "substantial interest" of at least 20 per cent is held by a foreign person (or an aggregate substantial interest of 40 per cent if there are two or more foreign persons), which is equivalent to the Foreign Investment Review Board requirements. In Queensland and South Australia the entity must be 50 per cent or more foreigncontrolled (shares and voting rights). Curiously, the Victorian provisions require a single foreign person to have a 50 per cent (capital) interest and the interests of unrelated foreigners are not aggregated. Due to tracing and deeming provisions, the potential scope for an investor to be "foreign" is far-reaching, and not always obvious.

Combined with this, the concept of residential property varies between States and can be broad.



The rationale for these measures has variously been described as ensuring that foreign investors contribute appropriately to local infrastructure, or easing the pressure on housing supplies for Australian residents, in particular first-home buyers.

Measures announced in the recent New South Wales Budget, for example, are forecast to raise

the measures may have a broader impact on the Australian residential development market than expected.

KEY ELEMENTS OF THE SURCHARGES ON LAND PURCHASES

Each of the eight Australian States and Territories imposes a real estate transfer duty payable on the purchase of land. The rate and scope For example, the provisions in New South Wales apply to any land, not including primary production land, on which there are one or more dwellings and also includes vacant land zoned as residential. "Residential property" in Victoria is defined as land capable of being used solely or primarily for residential purposes and that may lawfully be used in that way. The rules and their interpretation vary such that serviced apartments, retirement villages and student accommodation can be in or out of the provisions depending on the State, and the precise attributes of the facility.

To add to the complexity, some of the rules have a forward-looking test. For example, in Victoria, where a foreign purchaser acquires property that is not residential property, and that foreign purchaser forms the intention to use the land for residential purposes after the property is acquired, the foreign purchaser is required to notify the revenue authority and pay the foreign purchaser duty surcharge. In Queensland and South Australia, the foreign purchaser duty surcharge attaches if the purchaser is a corporation or a trust which becomes foreign-controlled within three years of the time the liability for transfer duty arose.

DEVELOPER EXEMPTIONS

The provisions in New South Wales, Victoria and Queensland do recognise, to varying degrees, that the surcharge should not operate to discourage foreign developers, or to create an unlevel playing field with local developers. Each has introduced some measures to take certain activities outside the surcharge. However, these measures are largely discretionary, and apply a myriad of guidelines and restrictions which can be cumbersome. In each case, applications must be made for

exemptions to apply and this can delay transactions.

For example, the Queensland provisions give the Commissioner of State Revenue a discretionary power to grant ex gratia relief if the foreign purchaser is, among other things, a "significant developer". In Victoria, the Treasurer may grant an exemption for a company incorporated in Australia if its activities in the development or redevelopment of property adds to the supply of housing in Victoria. However, a foreign company is not eligible for exemption.

surveillance of the entity's activities. The need to pay the surcharge and seek a refund (possibly several years later) adds complexity to the system.

Under the proposed New South Wales developer exemption, a refund of the foreign purchaser duty surcharge paid will be available where the revenue authority is satisfied that:

 the Australian developer or a related body corporate constructed a new home on the residential land to which the residential-related property relates after completion of the transfer



Previously, there was no similar exemption in New South Wales for developers. However, the recent New South Wales State Budget announced the introduction of a refund system for companies incorporated in Australia that construct new homes on residential land where the developer is incorporated in Australia. Again, incorporation in Australia is essential for these rules to operate, presumably to allow greater

- of the property to the Australian developer;
- the Australian developer has sold the new home to a person other than an associated person; and
- the home was not occupied or used as a place of residence or for any other purpose at any time between completion of construction of the home and completion of its sale.

An application for refund must be made within 12 months of



completion of the sale of the new home and no later than 5 years after completion of the transfer of the residential-related property to the Australian developer.

ONGOING LAND TAX SURCHARGES

In addition to stamp duty on purchases, all Australian States and Territories, other than the Northern Territory, impose a land tax on an annual basis on the unimproved value of land. The rate of annual land tax varies but is typically between 1.5 per cent and 2.25 per cent of the unimproved land value. Land tax applies in the same manner to all types of land (e.g. commercial, industrial and residential), subject to exemptions for principal place of residence and primary production land.

The measures aimed at foreign purchasers extend to foreign ownership in the form of a land tax surcharge which applies on top of the normal land tax where a foreign person owns residential land in New South Wales or any land in Victoria. The surcharge payable in New South

Wales and Victoria on top of the general land tax rate for the 2017 land tax year is 0.75 per cent and 1.5 per cent respectively. For the 2018 land tax year the foreign-owner land tax surcharge increases to 2 per cent in New South Wales.

Exemptions from the foreignowner land tax surcharge may be available

VACANT RESIDENTIAL PROPERTY TAX

Finally, in a move to discourage residential land being left unrented, from 1 January 2018, Victoria will impose a Vacant Residential Property Tax of 1 per cent of the capitalimproved value of property in certain areas of Melbourne which is left unoccupied for six months or more in a calendar year. Based on the Minister's Second Reading Speech, this aims to "incentivis[e] Melbourne's current housing stock to be put to its most efficient use". There is no concession for land held vacant pending redevelopment.

The Federal Government also proposes to introduce a charge on foreign owners of residential

property where the property is not occupied or genuinely available on the rental market for at least six months a year. The charge will be levied annually and will be equivalent to the foreign investment application fee imposed at the time of acquisition of the property.

HARMONISATION

Probably the most striking feature of the new rules is the lack of consistency between States and, due to the State/Federal system, the overlay of Commonwealth initiatives. These don't always work coherently together and may lead to distortions in the market. It is hoped that, if these measures are to become an enduring feature of local taxes, they will be harmonised and simplified to reduce compliance cost.



Barbara Phair Partner T +61 2 9258 6584 barbara.phair@ashurst.com



Struan Davidson Lawyer T +61 2 9258 6098 struan.davidson@ashurst.com



The growth of retirement communities in the UK

by Donna Fleming and Louisa Bradley

It is estimated that over the next two decades, the number of people aged 65 and over in the UK will increase by more than 40 per cent¹ and by mid-2039, more than 1 in 12 of the population is projected to be aged 80 or over.² An ageing population, coupled with the increasing demand for homes across the country, has created a unique set of circumstances which will challenge the way we have traditionally thought of residential and care development schemes, encouraging an overhaul of housing development strategy in the UK. This raises important questions for the built environment sector, both in terms of the development of and investment in housing and care structures to cater for the ageing population.

The trends in the UK housing market have meant that older

members of the population have benefited from rapidly rising house prices. It is estimated that in the UK the over 50s hold 66 per cent of all housing wealth, equalling about £2.5 trillion. ³ The UK's retirees have significant equity wrapped up in under-occupied properties; properties which are not equipped to serve their owner changing community and care requirements.

The Associated Retirement Community Operators, the body representing the retirement community sector in the UK, estimates that 33 per cent of over 60s would want to move if suitable properties were available but there is a huge shortage of supply of suitable retirement communities;⁴ with Knight Frank noting in 2016 that only 3 per cent of new housing which had been granted planning permission was specifically for elderly or sheltered accommodation.⁵

The older population have huge potential spending power if suitable and appealing retirement properties were available: properties which would not only allow their owners to realise the equity that has built up in their current homes but also cater for a range of ever-changing and growing healthcare requirements; providing a supportive community within which to live and participate. Could the development of retirement villages and specialised senior living housing address the increasing costs and demands of community care and offer an answer to the housing crisis in the UK?

BREAKING THE MOULD

The market for US style retirement "villages" has huge potential for growth in the UK and offers many social and economic advantages. The concept is centred around self-

contained houses and apartments (which can be purchased or rented), with additional shared amenities, leisure facilities and activities available to all. On-site care provision would also be available if required and could be used to a greater or lesser extent depending on individual needs, thereby increasing the likelihood that residents in the villages would be able to stay in their own homes as they age rather than having to consider a residential care home.

Such developments are on the rise in the UK and this trend is likely to continue. In an effort to increase their appeal to consumers, developers are increasingly diversifying the products which they are able to offer.

In order to create a sufficient "pull" for people to consider moving, developers are seeking out unique and aspirational locations; often choosing stately homes as the centre of their schemes. There has also been a notable rise in mid-to high-end and luxury retirement properties aiming to capitalise on the increasing affluence of the over 65s and the wealth of the next generation of retirees.

LEASEHOLD AND OWNERSHIP STRUCTURES

There is also an increasing awareness among senior living providers of the need to offer consumers a choice of ownership models to suit a wide range of financial situations and arrangements.

In the past it has been most common for senior living facilities to offer leasehold ownership to occupiers, with service charge and ground rent charged to leaseholders. The operator would also usually benefit from an Event Fee which would be payable when the occupier vacated the property

The accepted leasehold model allows for an immediate return for a developer but may not suit a consumer who does not wish to reinvest their capital into a property, but would rather increase the money they have available to them in their senior years. Developers are increasingly offering private rental properties to consumers and shared ownership options are also on the rise. Care packages can also be purchased as necessary to prevent an increased cost for those



EVENT FEES

Event fees, (also known as exit fees, assignment fees, deferred management fees or transfer fees), require the owner of a retirement property to pay a fee to the operator (or sometimes the freeholder, developer or managing agent) of a scheme when they vacate the property. This could mean that an event fee becomes payable when the property is sold or underlet.

The event fee may be a percentage of the original purchase price or of the open market value of the property at the time of the relevant "event". The fee may be a flat rate percentage or a rate that increases for each year of occupation. Alternatively, the leaseholder may be required to sell the property back to the freeholder at the original purchase price, losing any increase in the value of the property.

Event fees have controversially become commonplace in the UK, facing criticism when the Office of Fair Trading reported that certain elements of transfer fees could render them potentially unfair contract terms and a breach of the Unfair Terms in Consumer Contracts Regulations 1999 (Office of Fair Trading, Investigation into retirement home transfer fee terms, a report on the OFT's findings (2013), OFT1476). The risk that an Event Fee could potentially be held to be unfair (rendering it unenforceable) has made investors nervous of lending on the security of an event fee income stream, meaning that funding for senior living projects has been difficult to obtain and, prompting a review of event fees by the Law Commission in March 2017 (Event Fees in Retirement Properties Summary, the Law Commission, March 2017). Although a response from the Government is awaited, the Law Commission has not concluded in favour of prohibiting event fees but rather has promoted the introduction of a code of practice when dealing with event fees; focusing on greater transparency and standardised information to be provided to consumers. This may offer some comfort to developers and investors until the Government responds fully to the Law Commission's Report.



who do not require substantial care. The increased flexibility around ownership and costing models is an important step forward for the industry, providing a variety of schemes to suit its increasingly diverse customer base which will encourage retirees to embrace the concept of retirement living.

THE GOVERNMENT'S RESPONSE

The growing pressure to provide a solution to the housing crisis has forced the Government to look to the top end of the housing chain for an answer; by capitalising on the initiatives of developers and

operators who have been working to increase the popularity of senior living schemes.

The Housing White Paper highlighted a commitment to improving options for older people by ensuring that there is a more consistent delivery of accessible housing and producing guidance for local planning authorities on how their local development documents should meet the housing needs of older people. Although the paper did not go as far as many in the senior living industry had expected or hoped, it did signal a clear indication that senior living was to be a focus area going forward.

INVESTOR APPETITE

The focus on senior living has not gone unnoticed by investors who are well aware of the pressure on

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 Secretary of State for Communities and
 Local Government. February 2017



the UK housing market and the growing wealth of the UK's retirees. Although investment in senior living has been slow in comparison to the huge growth in student housing and build-to-rent schemes, government funding cuts and the sharp demographic change make it increasingly difficult for local authorities to fund the needs of the growing ageing population.

Historically poor returns on such investments along with high maintenance bills and the unpopular event fees hindered investment, but senior living investment is seeing increased activity. Luxury senior living provider Pegasus Life, which is owned by Oaktree Capital Management, has an estimated value of £500 million and recently Impact Healthcare REIT raised £160 million through an IPO. Whereas the Moorfield Audley Real Estate Fund has raised £285 million of equity in recent years.

CONCLUSION

In a market where demand far outweighs supply and the fact that investors are seeking to diversify their portfolios and secure long-term income means that senior living is set to become an increasingly popular real estate asset.

Whether the Government's policy making will go far enough to revolutionise the top end of the housing chain remains to be seen, but the growing popularity of retirement villages with consumers suggests that they will become a key feature of the UK's housing market and therefore a key asset for investment.



Donna Fleming
Partner
T +44 20 7859 1415
donna.fleming@ashurst.com



Louisa Bradley
Associate
T+44 20 7859 2280
louisa.bradley@ashurst.com





An attractive investment vehicle

by Arnaud Wtterwulghe, David Du Pont and Jörg Heirman

Investing in RECs combines the best of both worlds: the security and stability of a real estate investment with the flexibility of a stock exchange based transaction.

BACKGROUND

Belgian real estate certificates (certificats immobiliers/ vastgoedcertificaten, hereinafter "RECs") were created in the 1960s to (partially) finance the development of substantial properties such as shopping centres. While very popular at first, the success of RECs decreased when, as a result of the introduction of severe laws on new commercial premises, the construction and development of such premises dropped drastically. RECs experienced renewed success in the middle of the 1980s when "new generation"

RECs were issued. From then on, RECs became a genuinely liquid real estate investment although they did lose some popularity following the success of certain types of Belgian REITs (first sociétés d'investissement à capital fixe/vastgoedbevak, and then also more recently with sociétés immobilières réglementées/gereglementeerde vastgoedvennootschappen).

RECs are currently considered an attractive investment vehicle for those who are looking for investment opportunities in a relatively secure and tax-friendly environment, but who also want to retain a certain level of flexibility. RECs are also seen as a useful means of financing average-sized and/or local developments.

CHARACTERISTICS

- RECs are certificates issued to (re) finance a real estate investment,
 e.g. the acquisition, refurbishment
 or construction of one or more
 specific properties (commercial
 properties, but also office or
 logistics properties).
- RECs represent a receivable on the issuing company equal to the net proceeds (as defined below) generated by the underlying property(ies).
- The issuing company or a third company in a partnership without legal personality (société civile/maatschap) with the issuing company (for further details regarding such partnership, please see the section below entitled "Structuring RECs") is the legal owner of the property and is as such responsible for the

- maintenance and operation of the property, while the **REC holder only has the beneficial ownership** of the property(ies).
- RECs are issued by way of a private or public placement.
- RECs are issued for a defined term (usually 20 to 25 years) and terminate upon sale of the underlying property(ies).

ECONOMIC VALUE

RECs split the legal and economic ownership of a property: the issuing company (or a third company that is in partnership with the issuing company) is the owner and/or manager of the property, while the economic (net) benefits of the property are transferred to the REC holders

More specifically, the holder of a REC receives:

an "annual" coupon comprising (i)
 a proportional share in the annual
 "net proceeds" derived from the
 operation of the property during
 the year concerned, being the

difference between all proceeds (e.g. rent, default interest paid by lessees, etc.) and all expenses (e.g. maintenance and reparation costs, taxes, insurance premiums, etc.) in connection with the property, and (ii) a capital reimbursement to repay part of the principal invested amount; and, upon sale of the property, a "special" coupon comprising (i) a proportional share in the net proceeds resulting from the sale of the property (i.e. sale price less sale costs (including the reimbursement of any loan), commission rates. losses carried forward and all other costs relating to the property) and (ii) a capital reimbursement to repay the balance of the principal invested amount, to the extent this has not yet been entirely repaid at the time of the sale.

From an economic point of view, the REC holder is in the same position as the owner of a rented property. However, in contrast to such owner, a REC holder is not involved in the operation of the property (e.g. property maintenance, letting and sale of underlying properties, etc.) which is taken care of by the issuing company (or a third company that is in a partnership with the issuing company).

ADVANTAGES AND RISKS

The advantages of RECs make them an attractive way of investing in real estate projects:

- it is possible to indirectly invest in real estate with only a limited amount of capital;
- REC holders are protected against inflation due to the fact that the rental income of the property is (usually) index-linked;
- RECs are a simple way of investing in real estate projects, without the practical concerns usually associated with real estate investments (e.g. construction, renovation, letting, collection of



rent, etc.), as this is taken care of by a separate, specialised company;

- RECs can be transferred fairly quickly, without the need to comply with any particular formality (as such a transfer does not require the execution of a notarial deed). Similarly, tax, fees and costs charged as a result of a property sale do not apply to the sale of a REC; and
- issuers of RECs are not subject to the complex and burdensome regulatory constraints that are imposed on Belgian REITs.

On the other hand, investing in RECs remains subject to certain risks:

- insolvency risk of the company that issued the REC;
- RECs remain subject to price fluctuations: the value of a REC is to a great extent dependent on price fluctuations on the real estate market and the value and characteristics of the underlying property;
- proceeds of the REC are uncertain, e.g. the underlying property cannot be let for a certain period of time which in turn means that no net income can be distributed for that period;
- in contrast to shares issued by Belgian REITs, the liquidity of RECs is limited, which could have a negative impact on the purchase price in case of a REC transfer.

DIFFERENCE WITH BELGIAN REITS

The main differences between a real estate investment structured through RECs and an investment by means of buying shares in a Belgian REIT, are summarised as shown in the table below.

STRUCTURING RECS

Issuing RECs generally involves the intervention of one or more company(ies) to issue the RECs, own the property and manage the latter. In some cases, the issuing company is also the company owning and/or managing the underlying properties. In other cases the issue of the RECs, the legal ownership and/or the management of the underlying property are spread across the different companies which enter into a partnership without legal personality. The issuing company will

then collect the necessary funds to finance the real estate project, while the company owning the underlying property will contribute the benefits of the property in the partnership so that these can be distributed by the issuing company to the REC holders.

RECs can be issued by way of a private or public placement. In the event RECs are offered to the public, such offer will be subject to supervision by the Belgian Financial Services and Markets Authority (FSMA) and needs to comply with the Belgian Prospectus Law of 16 June 2006 (the Prospectus Law). A public placement of RECs will thus imply drafting a prospectus containing the information required for investors to be able to make an informed judgement about the investment.

If the issue of RECs does not qualify as a public placement (e.g.

Belgian REIT	RECs	
Diversified real estate portfolio	Limited to a single or a limited number of properties	
Expected return is usually lower	Expected return is usually higher	
More liquid	Less liquid	
Less knowledge of the real estate market is required	Good knowledge of the specific real estate investment is recommended	
Legal framework closely regulated	Flexible legal framework	





the RECs are only offered to qualified investors, or to fewer than 150 natural or legal persons, or where one of the other exceptions in the Prospectus Law applies), the RECs can be issued through a private placement for which no prior authorisation by the FSMA or the drafting of a prospectus is required, resulting in lower issue costs.

TAX TREATMENT AND OTHER COSTS

The following tax treatment applies to the issuing company and the REC holder:

 Issuing company – corporate income tax: Issues of RECs are usually structured in a way which is tax neutral for the issuing company which owns the property. The repayment of the initial invested principal amount is not deductible as a professional expense, but can be set off against the tax deductible depreciation of the property if these repayments are spread over a period equal to the deprecation period of the property.

The annual net proceeds derived from the property and capital gains resulting from the sale of the property are as a matter of principle subject to corporate income tax. However, as both proceeds (after deduction of costs) are distributed to the REC holders under the form of interest (see below), this operation should be tax neutral for the issuing company as it will deduct these distributions as professional expenses.

• REC holders – withholding tax:
The "annual" coupon paid to
REC holders resulting from
the net rental income of the
property is divided into two parts.
The first part is treated from
a tax perspective as a capital
reimbursement and therefore not
taxable. The second part qualifies
as "interests" within the meaning
of Article 19, § 1,1° of the 1992
Belgian Income Tax Code and is
therefore subject to a withholding
tax of 30 per cent.

Upon sale of the property, a proportion of the sales price, including the capital gains (if any), will be allocated to the REC holders as a "special" coupon. Tax will only apply to the part of the "special" coupon that exceeds the REC holders' investment that has not yet been repaid through the annual coupons. For private individuals the tax will be limited

to a withholding tax of 30 per cent. In other words, a withholding tax is levied on the capital gains but not on the capital reimbursement.

If the REC holder is a for profit company, the interest ("annual" coupons) or capital gains ("special" coupons) derived from the property are considered to be ordinary business income and will therefore, in principle, be subject to the ordinary corporate income tax rate of 33.99 per cent. In contrast, any capital loss suffered by the company on the sale of its RECs is tax deductible.

Any withholding tax deducted at source can normally be credited against the corporate income tax pro rata based on the ownership of the REC, but there are limitations for crediting the withholding tax on the "special" coupon in case the RECs have been held by other investors for whom the withholding tax is the final tax

Non-resident investors in RECs established in a country with which Belgium concluded a bilateral tax treaty may benefit from a reduced withholding tax rate (usually 15 per cent) or, under certain treaties, even a full exemption from withholding tax.

- REC holders stock exchange tax: In the event that the RECs are publicly traded, a tax of 0.27 per cent (max. EUR 1.600 per party and per transaction) applies on the transfer of RECs on the secondary market of the Belgian stock exchange.
- Other costs: Banks commonly charge fees to execute orders on the secondary market (brokerage fees) and to keep the RECs on a securities account (custody account fees).



Arnaud Wtterwulghe Managing Partner, Brussels T +32 2 626 1914 arnaud.wtterwulghe@ashurst.com



David Du Pont
Partner
T+32 2 626 1923
david.dupont@ashurst.com



Jörg Heirman Associate T +32 2 626 9939 jorg.heirman@ashurst.com



The future of bricks and mortar shops

by Henry Moss and Alison Murrin

Despite the continuing rise of e-commerce and the disappearance of a number of notable retailers from the high street, it is safe to say that bricks and mortar shops are very unlikely to completely disappear any time soon.

These days, online shopping could not be easier. You are able to browse a huge online inventory, make your purchase in a few clicks and have your items delivered straight to your door. Online retailers, without any physical shops, can minimise costly overheads such as rent and business rates. However the vexed question is whether bricks and mortar shops will become redundant.

Despite the continuing rise of e-commerce and the disappearance of a number of notable retailers from the high street, it is safe to say that bricks and mortar shops are very unlikely to completely disappear any time soon.

In fact it is very interesting to see that heavyweight online retailers such as Amazon are now beginning to embrace bricks and mortar.

Amazon has recently opened a physical book store in the US and apparently has plans to open a further 400 shops.

This shows that retailers realise that a physical presence can complement an online offering. The two are not mutually exclusive. Online retailers with a physical presence can showcase their products, giving customers a chance to try before they buy. Staff can interact with customers in person thereby improving customer relations. This all adds to a positive shopping experience and drives up sales in both the physical shop and online.

The competition between e-retailers is fierce and there is little to differentiate brands in a list of results from an internet search. Inevitably it will be the biggest brands that have the resources to ensure that their brand comes top in the results of any customer internet search. However, it seems that even internet giants such as Amazon are turning to bricks and mortar to drive sales

A physical shop enables retailers to promote their brand, increase visibility and ultimately attract customers. Furthermore, given that almost a quarter of all online purchases are returned, customers who are able to return goods to a physical store will reduce

that retailer's logistics costs for processing those returns and at the same time the customer has a further opportunity to shop in store.

CAN BRICKS AND MORTAR WORK HARDER?

Of course, there is no denying that these are challenging and unpredictable times for retailers. Profits are being eroded by rising costs and retailers are dealing with increasing business rates, fuel prices, staff costs and a weaker pound following the Brexit vote.

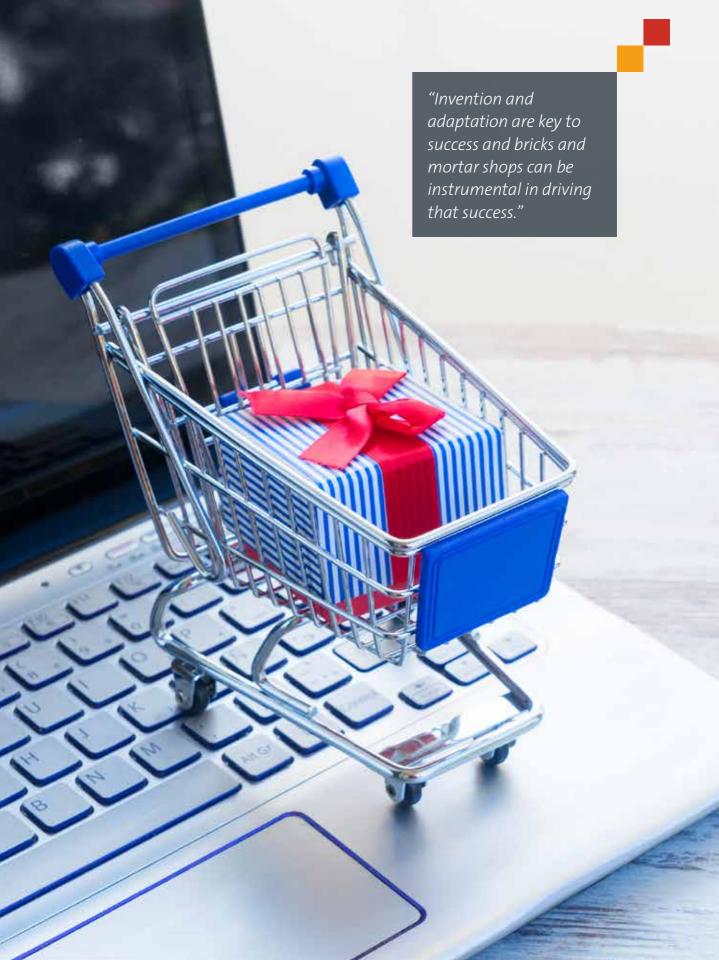
Therefore retailers know they must innovate to make their physical space work harder. This means looking at new technologies and embracing change. In turn this will enable retailers to achieve efficiencies and reduce costs, but at the same time improve the customer's shopping experience.

A number of retailers have taken the simple step of introducing more technology in store. In this way customers can still access the full range of online support and information while enjoying the benefits of seeing and buying the products in a physical shop.

Retailers are also improving the design and layout of their physical shops to attract customers inside. In this way customers are enticed away from their computers to enjoy a social shopping experience. Now you can visit a shop and at the same time you might enjoy a cup of coffee while browsing, and also take advantage of the complementary services on offer or speak to dedicated experts who can provide bespoke advice. This generally means that customers are likely to stay longer and hopefully spend more.

Retailers are also considering the type of space that will work best for their mode of business. There is no one-size-fits-all. A stand-alone flagship store may work for one retailer whereas another retailer may opt for a unit in a shopping centre







where footfall is guaranteed. You only have to look at the proliferation of pop-up shops to see that retailers are looking to use physical space more creatively.

Department store John Lewis is one example of this creative retailing. John Lewis has introduced "highlights" outlets which display a small fraction of their stock, while the rest of the inventory is available online. Internet furniture retailer Made.com recently opened a shop in London where designer furniture can be viewed but is purchased via an internet terminal located in the shop. In essence, the physical space is just a showroom.

Of course, this brings its own challenges for landlords of retail tenants as landlords have traditionally relied on the turnover lease. This lease model enables the landlord to take a fixed rent (usually at a discount-to-market rent) plus an agreed percentage of the tenant's store turnover. This essentially creates a situation where the landlord and the tenant are sharing both the risks and rewards

of the tenant's business. If the tenant's business is successful then the landlord will achieve a higher rental income. However, if the physical store is nothing more than a shop window then the turnover generated will be minimal. The rise of online shopping means that it is no longer possible to equate footfall with turnover and landlords are now considering how a retail tenant's online revenue should be treated when calculating turnover rent.

Of course, attributing the source of a sale is a matter for negotiation. For example, purchases made online and collected from the physical shop and purchases made from in-store internet terminals could all be said to fall within the definition of turnover generated at the tenant's premises. Furthermore, landlords may argue that items purchased online but returned to a physical store should not reduce the tenant's turnover for those premises. It is therefore critical that the lease clearly records the parties' understanding of how online sales will be treated in a turnover

calculation. This may meet with resistance from tenants, but it is vital that online sales are addressed. Of course, it may ultimately mean that the parties do not use a turnover lease at all and resort to a rack rent lease. However, it should still be possible to use turnover leases successfully provided both the landlord and tenant keep in mind that at the heart of the arrangement is an agreement to share the risks and rewards of the tenant's business.

SMART BUILDINGS

We are seeing that both building owners and occupiers are embracing a plethora of advanced new technologies that are now available to make their buildings smarter. Again, it is all about making the most of bricks and mortar premises. It is possible to capture myriads of data which can be used in many ways to increase footfall, inform retailers of customer shopping habits, manage stock and supply chains and reduce maintenance costs. Of course, as we discussed in the previous edition of this publication, the use and storage of personal data raises a number of legal issues particularly around the use, protection and security of that information

CONCLUSION

So, it does seem that bricks and mortar shops are here to stay for the foreseeable future, but retailers cannot afford to stand still. Invention and adaptation are key to success and bricks and mortar shops can be instrumental in driving that success.



Henry Moss Partner T +44 20 7859 2767 henry.moss@ashurst.com



Alison Murrin Expertise Counsel T +4420 7859 3123 alison.murrin@ashurst.com



MEET ASHURST AT EXPO REAL 2017

Representatives from the Ashurst European Real Estate team are attending the EXPO Real Conference in Munich from 4-6 October 2017.

If you would like to arrange a meeting at the conference please contact one of the attendees.

The team attending are:

Liane Muschter	Partner	+49 (0)69 97 11 26 08	liane.muschter@ashurst.com
Hendrik Theismann	Partner	+49 (0)69 97 11 28 11	hendrik.theismann@ashurst.com
Nicolas Deuerling	Partner	+49 (0)69 97 11 27 21	nicolas.deuerling@ashurst.com
Derk Opitz	Partner	+49 (0)69 97 11 27 07	derk.opitz@ashurst.com
Jan Krekeler	Partner	+49 (0)69 97 11 28 14	jan.krekeler@ashurst.com
Anna-Maria Krekeler	Associate, Rechtsanwältin	+49 (0)69 97 11 28 01	anna-maria.krekeler@ashurst.com
Hugh Lumby	Partner, Head of Global Real Estate	+44 (0)20 7859 1295	hugh.lumby@ashurst.com
Jessica Jenner	Partner	+44 (0)20 7859 2454	jessica.jenner@ashurst.com
Jamie Chapman	Partner	+44 (0)20 7859 1952	jamiegchapman@ashurst.com
David Jones	Partner, Head of Real Estate Capital Markets	+44 (0)20 7859 1983	david.jones@ashurst.com
Guillaume Aubatier	Partner	+33 1 53 53 56 98	guillaume.aubatier@ashurst.com
Thomas Ehrecke	Senior Associate	+33 1 53 53 54 81	thomas.ehrecke@ashurst.com
Hassan Javanshir	Partner	+33 1 53 53 55 87	hassan.javanshir@ashurst.com
Philippe None	Partner	+33 1 53 53 55 82	philippe.none@ashurst.com
Ismael Fernández Antón	Partner	+34 91 364 9853	ismael.fernandezanton@ashurst.com
Cristina Calvo	Partner	+34 91 364 9846	cristina.calvo@ashurst.com
David Du Pont	Partner	+32 2 626 1923	david.dupont@ashurst.com

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