REITs “made in Romania” - hopefully, the dawn of a new era

1. Overview

On September 3rd, 2024 the Senate passed the Bill no. PL-x no. 433/2024[1] on real estate investment companies –“ *societati pentru investii imobiliare”* (*real estate investment trusts* -“**REITs**”) and real estate companies – “*societati cu profil imobiliar*” (“**RECs**”) held by REITs and their respective tax regime (the “**Bill”**).

The Bill has long been awaited both by the real estate industry and investors and, more generally, capital markets institutions, due to the potential of increasing the presence of the real estate sector (as one of the growth drivers of the Romanian economy) on the stock exchange and providing new and appealing investment vehicles for investors.

REITs are regulated in most European countries as well as in the rest of the world[2]. Currently, all G7 countries and almost two-thirds of the OECD countries have established such entities, giving investors around the world access to portfolios of income-producing real estate[3].

The quintessence of REITs is that they are “pass-through entities” from a tax point of view so that taxation of incomes related to real estate assets will occur only at the level of the shareholder (investor) and no longer at a double level - company level and shareholder level.

Romania is one of the few countries in Europe which has not established a specific legal framework for REITs yet. In the absence of harmonized EU legislation on REITs, previous attempts to regulate such vehicles in Romania have failed; however, this time around, the context seems to allow a more favorable outcome for proper regulation and implementation, considering also that such new legislation was included in OECD’s recommendations on the Romanian capital markets[4].

As such, the Bill is meant to fulfill this objective by regulating REITs as well as the related concept of RECs, both of which will be subject to mandatory requirements and significant (tax) benefits.

2. REITs

2.1 Conditions to qualify as REITs

There are several requirements (described below) that companies must meet in order to be recognized as REITs:

(a) to be established as joint stock companies (but not micro-enterprises);

(b) to be registered in Romania[5];

(c) to be listed on a regulated market in Romania.[6] By way of exception, for a transitory period of 18 months as of entry into force of the Bill, a company starting the listing process is recognized the REITs status, subject to a successful admission to trading on a regulated market prior the expiry of this transitory period.

Comment: *Under the Bill's current form, companies listed on a multilateral trading facility (MTF), such as AeRO operated by the Bucharest Stock Exchange, are not eligible for REITs classification. However, considering the stage of development of the domestic capital markets and the tight conditions applicable to companies listed on a regulated market as compared to those listed on a MTF, this option may be also further considered.*

The conditions for listing on the AeRO market are lighter; by way of example, the anticipated market capitalization needs to be at least EUR 250,000 (for standard tier) for companies listed on the AeRO market versus EUR 1 million for companies listed on the regulated market.

Therefore, reference not only to the regulated market but also to MTF could be considered in the legislative process to allow more flexibility and generate more attractiveness to obtain REITs classification. Such flexibility is allowed in other EU jurisdictions such as Spain, Portugal, Italy, Finland. That would preserve a reasonable standard of transparency and accountability while preventing the monopolization of the REITs by the big players on the market.

Additionally, limiting the possibility to list the REITs only to the domestic regulated market could be also re-considered, in order not to generate concerns from the perspective of a potential limitation of the free movement of capital in the EU/EEA. Many of the EU jurisdictions consider that that requirement is met also in case of listing on an EU/EEA regulated market, rather than only on a domestic one.

(d) their main business object to be exclusively the purchase, sale and rental of real estate assets (or similar activities of conveying or acquiring the use of real estate assets) as well as exploitation, operation, management and development of real estate projects;

(e) at least 75% of their revenues derive from real estate activities described in letter d. above, including dividends from RECs or other REITs;

(f) distribution of at least 90% of their profit (after the statutory reserves have been established) by the end of the next fiscal year. REITs and RECs are not allowed to conclude any agreements with third parties related to restrictions on dividend distribution contrary to the above, except for credit agreements concluded with financial institutions.

Comment: *This exemption from the dividend distribution probably intended to ease up bank financing (giving that restriction on dividend distribution is customary especially in financing deals) should be written in more detail to clarify its scope – does it allow the financial institutions to impose contractually a total ban on dividend distribution or just a lower minimum threshold than the legal 90% threshold? This clarification sems necessary also from the perspective of the rationale of dividend distribution obligation regulated by the Bill, which seems related to the taxation exemptions granted to REITs and RECs, so that by mandatory dividend distribution it is ensured the income is transferred at the investor level where it is also taxed.*

We note that REITs are not subject to an express specific minimum share capital requirement, as in other jurisdictions, adding to the flexibility of the concept[7]. However, implicitly, requirements related to either minimum capital and reserves of at least EUR 1 million or an anticipated market capitalization of at least EUR 1 million need to be met for listing on a Romanian regulated market[8].

2.2 What investments can REITs pursue?

As indicated by their legal definition, REITs are designed to carry out real estate investments either directly in assets or, indirectly, by investing in RECs, or other REITs. Hence, a great degree of flexibility is embedded in their proposed legal definition.

As such, the Bill confines the types of investments REITs are permitted to pursue to the following:

(a) shares in other REITs, but no more than 10% of the share capital;

(b) minimum 95% of the shares in RECs.

Comment: *While not included as an express prohibition, there seems to be an implicit prohibition for REITs to hold shares in other companies than RECs and other REITs, which should be seen rather as a positive restriction protecting the inner nature of REITs*;

(c) real estate assets for the purpose of generating income from the sale, rental or any other form of conveying the use right over such assets.

Comment: *The concept of "real estate asset" should be defined in the law to avoid the risk of diverging interpretations;*

(d) other types of investments with a predominantly real estate profile including recreational centers, social facilities, shopping centers, service centers.

Comment: *It is not clear what exactly is meant by "investments with a predominantly real estate profile", as there is no general definition but only some examples (however, they seem to cover only direct asset investments; nevertheless, a clarification in this respect would be most welcomed*);

(e) long-term use rights over immovable assets (minimum 10 years), including rental, concession or any other form of acquiring the right to use real estate assets, for the purpose of transferring those rights to third parties and of obtaining income;

(f) immovable assets used in agriculture or forestry to produce agricultural products or for the exploitation of forests;

(g) movable or immovable assets required for carrying out their activity.

2.3 Who can establish REITs?

REITs may be incorporated by any public or private entity or individual. Of course, the requirement of listing on a regulated market may limit the interest to incorporate REITs to the sphere of the big market players.

If incorporated by the State or other public entity, it should hold at least 25% of the REITs share capital, but no more than 75%. As such, REITs may act as an efficient tool of State-driven investments in real estate sector.

Unfortunately, unlike in other jurisdictions such as Belgium, Japan, China, Turkey[9], investment in infrastructure specific to State intervention is not regulated and not even mentioned by the Bill.

3. RECs

RECs are defined as (limited liability or joint stock) companies registered in Romania or other EU country, which are held by a REITs in proportion of at least 95% and have as main business object the purchase and sale of real estate, the operation, management and/or development of real estate projects and renting of its own real estate assets.

RECs are required to distribute as dividends to REITs and, if the case, to the other shareholders, 100% of the profit (after the legal reserve has been established) until the end of the financial year following that in which it was obtained.

The high proportion required for dividend distribution (90% for REITs and 100% for RECs) is a consequence of their 'pass-through entities' nature (see Section 5.1 below)[10].

4. Operational limitations/obligations of REITs and RECs

The Bill regulates common obligations and limitations related to the activity of REITs and RECs:

(a) Loan to assets ratio - contracting third party loans is allowed up to 65% of the value of its aggregated assets (probably, the total assets on the balance sheet);

(b) Ring-fenced collateral – any guarantee created to secure loans from any third party must be limited to the "*assets related to the financed project*". This is normally meant to prevent the spread of foreclosure risk of underperforming investments/assets to the performing ones.

Comment*: This restriction needs to be further detailed or clarified; as it is written now, it seems to entail that security may be limited to project finance type of credit (e.g., a credit line taken for the general needs of the company or for other specific purposes would not be able to be secured, which would be quite unreasonable). Such potential prohibition (based on a possible interpretation of the Bill's current wording, as mentioned above) would be exaggerated, although the benefits of ring-fencing are generally well received by the markets.*

(c) No contractual restrictions on the dividend distribution are allowed, except for the credit agreements concluded with financial institutions;[11]

(d) Requirements of annual independent expert valuation of the immovable assets owned by REITs and RECs in their respective portfolio;

(e) Obligation of REITs to subscribe insurance for all immovable assets owned by them and to procure that the RECs in their portfolio subscribe insurance for their own immovable assets.

Comment*: No de minimis requirements/parameters are regulated for such insurance, hence this requirement seems rather a "tick the box" kind of item.*

5. Benefits of REITs and RECs

5.1 Corporate tax exemption (the "pass-through" principle)

Under the existing legislation, real estate investments are burdensome, as, in addition to the rather high capital required to be invested in a real estate, from a fiscal perspective, generally the real estate investments are subject to double taxation, that is: (i) taxation of the revenues of the real estate company and (ii) taxation of the dividends distributed to shareholders.

In line with international standards, the Bill aims for a more favorable fiscal regime, as the income of both REITs and RECs would be considered as non-taxable if resulting from: (a) sale and/or conveying the use of real estate assets, (b) maintenance and/or management of real estate assets, (c) dividends from RECs and other REITs, (d) sale of equity interests in RECs and securities in other REITs and (e) interest on loans extended to RECs.

As such, double taxation is avoided in the case of REITs and RECs that are deemed to be "pass-through entities", thus ensuring that the income is taxed only upstream at the level of the investor (*i.e.*, by the dividend tax) and not also downstream at the level of the entity holding the real estate assets/business.

REITs must fulfil the requirements under Section 2.1 above on a continuous basis to benefit of the tax facilities granted by the Bill. Otherwise, if the relevant REITs have failed to take all the necessary measures to ensure compliance with these requirements within a term of 6 months since such requirements were no longer met, the respective REITs and the RECs in their portfolio must retroactively pay the profit tax for those 6 months.

The procedure for the granting/recognition of these tax exemptions for REITs is to be enacted by the Romanian fiscal authority (ANAF). However, the Bill already provides for a self-certification mechanism whereby the REITs must file with ANAF every quarter an affidavit that they fulfil the conditions for the tax exemption as REITs.

5.2 Other benefits

While the tax benefits are the only benefits expressly regulated by the Bill, REITs come with other additional benefits which are quite substantial on their own, at micro and macro level.

As listed companies, REITs must ensure a strong and continuous transparency and better corporate governance as well as an appropriate oversight for investors.

REITs also offer enhanced diversity and, therefore, predictability and stability of incomes and give access to the wide public to invest in high-value real estate assets that would otherwise be prohibitive. They are in a way a "democratization tool" for real estate investments but also a "knowledge tool" bringing an increased level of sophistication to the Romanian real estate environment.

Lat but not least, REITs may be seen as a "securitization tool" that shift the focus from the particular assets to a pool of assets gathered by professionals under the same umbrella (RECs, REITs) with the important benefit that the individual/small investors investing *via* REITs in real estate will no longer bear the burden of managing individual assets (maintenance and repairs costs, relationship with tenants and authorities etc.).

6. Next steps

In order to enter into force, the Bill needs to be adopted by the Chamber of Deputies (the decisional forum).

Considering the potential significant impact both on the real estate industry and capital markets, it is to be expected (and it would be indeed recommendable) to further clarify certain key aspects in order to ensure a smooth implementation of the Bill.

For example, apart from certain key aspects outlined above, the interplay of the new REITs law with the existing legislation governing alternative investment funds[12] should be further reconsidered[13], especially because alternative investment funds[14] specialized in real estate investments are subject to strict domestic authorization and regulatory requirements, being supervised by the Financial Surveillance Authority.

Following its enactment and publication in the Official Gazette, the Romanian fiscal authority (ANAF) should issue the procedure for ascertaining the fulfillment of the criteria for REITs' recognition within 60 days since the entry into force of the law.

We are looking forward to seeing the Bill adopted, hopefully, in the months to come, and believe REITs may be the catalyst of a more sophisticated, better regulated and rational real estate market in Romania.

---

1. https://www.cdep.ro/pls/proiecte/upl_pck2015.proiect?cam=2&idp=21714.

2. REITs in Europe have been regulated (mostly between 2003 and 2011), for example, in Netherlands as early as 1969, in Germany, Spain, France, Portugal, Greece, Ireland, and even in Bulgaria as early as 2004. Worldwide, REITs are regulated in countries such as US, Canada, Brazil, China, Australia, India, Japan, etc. (source: Comparative summary table of European REIT regimes published by European Public Real Estate Association 2023: https://www.epra.com/application/files/8716/9383/3509/Comparative_summary_table_of_European_REIT_regimes.pdf).

3. See footnote 2 above.

4. See page 21 of Capital Market Review of Romania – towards a national strategy https://www.oecd.org/en/publications/2022/06/capital-market-review-of-romania_165ea5cd.html .

5 While it is common practice in EU countries to have the registered REITs incorporated domestically, some, such as France, Italy or Spain, allow a subsidiary of foreign REITs to benefit from the special regime of national REITs, provided that certain conditions are met (source: see footnote 2 above).

6. Most countries require REITs to be listed (*e.g*., UK, Belgium, Germany, Ireland), while Lithuania and the Netherlands do not have such requirement ((source: see footnote 2 above).

7. Minimum share capital requirements vary from EUR 1.2 million in Belgium to EUR 15 million in France or Germany, and as much as EUR 25 million in Greece where there is a much lower threshold of EUR 25,000 in Ireland (source: see footnote 2 above).

8. The listing requirements for the Romanian regulated market include: a) a minimum free float requirement of 25% (which can be waived under certain conditions), b) minimum capital and reserve requirements of at least EUR 1 million in the previous financial year or anticipated market capitalization of at least EUR 1 million and c) the company must have functioned in the past 3 years prior to the admission to trading requirement and must have prepared and communicated financial reporting for such period, in accordance with the applicable legislation (i.e., the financial statements need to be prepared in accordance with IFRS).

9. See footnote 2 above.

10. Regulation of REITs in other jurisdictions typically require 70-100% of the profit is to be distributed in a short period of time (*i.e.,* annually/for each financial period/by the end of the following financial year/on or before the tax return filing date for the relevant accounting period).

11. See relevant comment under Section 2.1 letter f) above.

12. Law no. 243/2019 regarding the regulation of alternative investment funds and modification of certain normative acts (“**AIF Law**”).

13. According to the endorsement provided by the Financial Surveillance Authority (“**FSA**”) in the legislative process at Senate level, to the extent the scope of the activity of the REITs s includes also holding in its “portfolio” shares in RECs, it may not be excluded that such activity could represent investment activity triggering potentially application of the licensing regime under the AIF Law. Therefore, the FSA recommends that the nature and purpose of the REIT is clearly determined in the law in order to avoid classification as alternative investment funds specialized in in real estate and application of a strict licensing and surveillance regime specific to collective investment undertakings.

14. The legal definition of an alternative investment fund is very broad, including “*entities which raise capital/attract funds from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of these investors*”. As such, it is not easy to distinguish between ordinary commercial companies and alternative investment funds specialized in real estate investment simply on the basis of the definition (basically between the “*commercial*” purpose of an ordinary REITs company and the “*investment* ” purpose of an AIF) and a legislative clarification would be much appreciated in the industry.