

# MIXED FUNDS

## ESSENTIAL ASPECTS

### LEGAL REGIME

The legal framework for Portuguese Real Estate Investment Funds (REIFs) is set out in Law-Decree no. 13/2005 of the 7th January. It stipulates that several relevant aspects are to be regulated by the supervisory authority, namely the Portuguese Capital Markets Authority (*Comissão do Mercado de Valores Mobiliários or CMVM*). The CMVM has accordingly regulated the activity through Regulation no. 8/2002, published in the official state journal (*Diário da República, II série*) on 18/06/2002.

The assets of a REIF can be comprised of:

- (Art. 25 of Law-Decree 13/2005)
  - Properties that can be included in the assets of an investment fund, held either through **right of ownership, building leasehold** or through other rights of equal content, the said properties being free of any encumbrances or responsibilities that may hinder significantly their capacity to be transacted.
  - Properties held by real estate investment funds will be **town properties or independent apartments.**
  - Properties under joint ownership with other investment funds or pension funds, subject to the existence, when applicable, of an agreement on the establishment of the division of the property or the sharing of the income generated by the real estate.
  - **Liquidity** – cash, bank deposits, deposit certificates, participation units in treasury funds and securities issued or guaranteed by a Member-State of the European Community with a residual maturity no less than 12 months.
- (Art. 25-A of Law-Decree 13/2005)

➤ **Stakes in real estate companies** subject to:

- a) The object of the real estate company fitting exclusively in one of the activities that can be directly developed by the investment funds;
- b) The real estate company's assets being made up of at least 75% of properties capable of being directly integrated in the investment fund;
- c) The real estate company not possessing any stakes in any other companies;
- d) The real estate company having its real and statutory defined headquarters in the territory of one of the Member-States of the European Union or of the OECD in which the respective investment fund can invest;
- e) The real estate company's accounts being subject to a regime equivalent to that of investment funds with regards to independent auditing, transparency and disclosure;
- f) The real estate company contractually agreeing with the entity managing the investment fund to provide all the information that the latter must send to the CMVM;
- g) Applying equivalent principles to those that apply to other investment funds, namely in regards to the rules of appraisal, conflicts of interest and disclosure of information, in relation to the properties and assets that are included in the real estate company's capital or that are acquired, exploited or sold by it.

- (CMVM Regulation 8/2002 Art. 6)

➤ Units in other real estate investment funds limited to 25% of the total assets of the funds on behalf of which the acquisition is made and a managing entity can not acquire more than 25% of the units of a REIF amongst the set of funds that it manages.

**Characterization:**

The mixed real estate investment funds are characterized by Chapter V of Law-Decree 13/2005. The capital of these mixed investment funds is comprised of a fixed portion and a variable portion, represented by two distinct categories of units. The fixed portion of the mixed investment fund's capital can not be less than the variable portion.

*"The subscription and redemption price of the units that represent the variable portion of the investment fund's capital corresponds to the value established in the respective management*

*regulation, either augmented or diminished accordingly by the eventual subscription or redemption commissions that must be paid by the unitholders. (art. 53 of Law-Decree 13/2005).*

These funds can be managed by fixed or movable asset management companies (art. 6 of Law-Decree 13/2005).

With the unit subscription, the unit holder grants the managing company a broad mandate to manage its account. More specifically,

➤ *“The managing companies can not transfer to third parties all the management powers over the investment funds that are granted to it by law” (art. 6, no. 4, Law-Decree 13/2005)*

➤ *“In general, the managing companies are responsible for the all actions and functions necessary or convenient for the thorough administration of an investment fund, in accordance to the highest standards of diligence and professional competency, and in particular:*

*a) Select the assets that should make up the investment fund according to the investment policy foreseen in the respective management regulation; “(art. 9, no. 2, Law-Decree 13/2005)”*

➤ *Under no circumstance can the unit holders assembly pronounce itself on specific investment decisions or approve guide lines or recommendations on this matter outside the scope of the exercise of this capacity referred to in paragraph b) of the previous number (“substantial modification of the investment policy of the investment fund”); (art. 45, no. 2, Law-Decree 13/2005)*

## **ASSET MIX RULES**

The REIF asset mix rules are set article 38, no. 1 of Law-Decree 13/2005, in which the following limits are established (calculated in accordance with the REIFs gross asset value):

- minimum investment in real estate (75%; paragraph a);
- maximum investment in building projects (25%; paragraph b);
- maximum investment in a single property or comparable asset (20%; paragraph c);
- maximum exposure to leases to a single tenant (20%; paragraph d);
- maximum investment in real estate companies (15%, paragraph e);
- maximum leverage (25%; paragraph g).

The regime established for mixed funds **is more restrictive**, as it does not permit any type or amount of debt.

### TAX REGIME

Although they do not have legal personality (“*under the special regime of joint ownership regulated by the present diploma, they constitute autonomous assets that belong to a plurality of natural and legal persons referred to as unit holders*” – art. 2, no. 2, Law-Decree 13/2005), the investment funds are subject to Corporate Income Tax (*Imposto sobre o Rendimento das Pessoas Colectivas or IRC*) under art. 2, no. 1b of the Portuguese Corporate Income Tax Code. The latter considers that the tax applies to all entities even if they do not have legal personality so long as they have headquarters or their effective management is in Portuguese territory and that the income is not taxed under Portuguese Personal Income Tax (*Imposto sobre o Rendimento das Pessoas Singulares or IRS*) or IRC.

The tax regime for REIFs is set out in art. 22 of the Tax Benefits Statute (*Estatuto dos Benefícios Fiscais, EBF*) approved by Law-Decree no. 215/89 of the 1<sup>st</sup> of July, which states that the income obtained will be taxed in an independent manner and through the application of rates that vary in relation to the income’s nature, and that those taxes are to be withheld by the paying entity in the same manner as if they were individuals residing in Portugal.

The following chart summarizes the tax regime in force for investment funds.

TAX	RATE	OBSERVATIONS
<b>On income deriving from</b>		
Securities	20%	
Rents	20%	Maintenance expenses are deductible
Financial capital gains	10%	Net of capital losses
Real Estate capital gains	12.5%	Revaluation of the acquisition cost and charges with the appreciation of the assets over the last 5 years
<b>On property</b>		
IMT (transaction)	Exempt, except if the unitholders are not expert investors, in case a 3 - 3,25% rate applies	
IMI (holding)	Exempt, except if the unitholders are not expert	

	investors, in case a 0,25% rate applies p.a.	
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■ Chart 1: Taxation on REIFs

If the unit holder is subject to *IRC*, the income from the REIF is considered revenue and the respective taxes that the REIF must pay will be treated as prepayments of taxes.

The investment funds are exempt of VAT but, on the other hand, cannot deduct VAT that is charged. If it is in the interest of the unit holders, the Fund can waive the right to this exemption.

The tax advantages of the funds is that they are exempt of some taxes, i.e. *IMT* (versus a general rule of 6 to 6.5%) and *IMI* (versus a basic rule of 0.5%), aside from the fact that, for individuals, the taxation of the income deriving from the fund is calculated at a fixed rate and deducted automatically upon payment; a system which tends to be more favorable than if the income were included in the individual's general income of the year.

These advantages apply fully if the unitholders are expert investors. If this is not the case, the Fund bears *IMT* and *IMI* at half the standard rates.

Portuguese law defines "expert investor" or "qualified investor" as (art. 30, n<sup>o</sup>1 of the security code:

- a) Credit institutions;
- b) Investment firms;
- c) Insurance companies;
- d) Collective investment institutions and respective managing companies;
- e) Pension funds and respective managing companies;
- f) Other financial institutions authorised or regulated, namely securitization funds, respective managing companies and other financial companies prescribed in the law, securitisation companies, risk capital companies, risk capital funds and respective managing companies;

- g) Financial institutions of non-European Union Member States that carry out business similar to any business referred to in the preceding paragraphs;
- h) Entities that trade in financial instruments on commodities;
- i) National and regional governments, central banks and public organizations that manage public debt, international and supranational institutions such as the European Central Bank, the European Investment Bank, the International Monetary Fund and the World Bank.

## **LEVERAGE CAPACITY**

Mixed investment funds do not have any leverage capacity.

## **ESTABLISHMENT AND MAINTENANCE COSTS**

The establishment of a Fund is initiated by an application drawn up by the Managing Company, which includes the Management Regulation that will regulate the operation of the Fund. This service is normally provided free of charge by the Managing Company, however, the client should consider his legal counsel costs, should he so wish them.

The Managing Company charges a management fee which is usually a percentage of the fund's net asset value.

The Custodian Bank charges a custody fee which is usually a percentage of the fund's net asset value.

The *CMVM (Comissão do Mercado de Valores Mobiliários)* charges a supervision fee.

Aside from these structural costs, the Fund will also bear the costs foreseen in its Management Regulation. One representative example of these costs is the following:

*“Aside from the management fee and the custody fee, the following will be considered costs of the Fund:*

1. *All the expenses related to the construction, acquisition, maintenance, leasing and sale of real estate property, namely:*

- a. *Drafting of projects, supervision of construction, licenses and other costs related to real estate construction and promotion;*
  - b. *Notary and public registry fees related to the obtaining of certificates required by the Fund;*
  - c. *Any taxes or fees required by the Fund;*
  - d. *All legal costs related to all cases in which the Fund is involved as an owner, as well as the professional fees or stipends paid to lawyers and solicitors;*
  - e. *Real estate agency costs, if such exist;*
  - f. *All costs related with the maintenance and/or improvements made to the assets of the Fund, including the various fees and taxes that exist or may exist in the future and that the Fund is responsible for.*
2. *Expenses related to insurance premiums of the Fund's properties.*
3. *Expenses related to studies, projects and appraisals of properties ordered by the Fund and included in its portfolio or on real estate property being analyzed in order to support an acquisition decision.*
4. *Any mandatory publications required of the Fund.*
5. *Advertising campaigns done with the objective of promoting the Fund's assets.*
6. *All the acquisition and sale expenses of the Fund's assets, namely:*
  - a. *Expenses related to bank transfers;*
  - b. *Expenses related to currency exchange;*
  - c. *Expenses related to transactions in the stock market;*
  - d. *Expenses related to transactions in the money market.*
7. *Fees charged by the Fund's auditor (Revisor Oficial de Contas).*
8. *Expenses related to the listing in a Stock Exchange or any other listing in a registered market.*
9. *Other duly documented expenses that are incurred in the fulfillment of the Fund's legal obligations.*