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LUXEMBOURG REAL ESTATE UPDATE

Sector overview

What should you remember?

The Real Estate (“RE”) sector was adversely impacted by COVID-19, and some of these impacts are still being felt. One such impact, the rise of interest rates globally, has negatively affected RE prices. Investors will have to adopt a more opportunistic approach in RE portfolios.

The European Union (“EU”) Renovation Wave presents a rare chance for opportunistic real estate investing strategies, as retrofitting initiatives can enhance property values and reduce operating costs.

Fast-paced changes in international taxation and regulatory requirements in the EU and beyond are further challenging investors to ensure that their structure are compliant. Luxembourg players should be well-positioned to deal with these challenges due to an extensive range of choice of entities and regulatory regimes. However, these changes can also be positive, such as in the case of the ELTIF’s reviewed regulations which allow RE & infrastructure investment. Luxembourg is already the number one destination for ELTIF’s in the EU, and their numbers are expected to grow significantly going forward.

As Millennials and GenZ’s progressively replace older generations in the market, either as investors or as renters, RE Asset Managers will be incentivized, if not driven, to adopt sustainable business practices and incorporate ESG principles into their functions as a means of attracting their clientele. RE Asset Managers that adopt ESG principles should therefore have significant competitive advantages in the long run.

1. A brave new world for Real Estate

New Challenges and Opportunities Ahead.

Even so, this environment also presents windows of opportunity for investors. As interest rates have risen, property prices have undergone and will continue to undergo adjustments, creating favorable conditions for those equipped with available reserves. By identifying undervalued properties and negotiating advantageous financing terms, investors can position themselves to capitalize on market fluctuations and realize long-term gains.

Under the EU Renovation Wave project, we expect a robust demand for the retrofitting of older commercial and residential buildings, with an aim of achieving decarbonization and meeting progressively more stringent environmental standards. For reference, under the Renovation Wave project, the EU Commission expects to have up to thirty-five million buildings renovated by 2030.

As sustainability and energy efficiency continue to gain prominence, property owners and investors are recognizing the need to upgrade existing structures to align with eco-friendly practices. In our view, this presents a compelling opportunity for opportunistic real estate investing strategies, as retrofitting initiatives can enhance property value and reduce operating costs. Investors who proactively seize this opportunity can position themselves for long-term growth and contribute to the sustainable transformation of the real estate sector.

2. Structuring complexity in view of continuous tax changes

Structuring opportunities.

Increasingly fast and complex changes in Tax law around the world have led to heightened complexity in investment structuring, including Real Estate investments. Investors must navigate evolving regulatory & tax laws and regulations in several jurisdictions, having to consider a myriad of elements such as interest limitation rules, anti-hybrid rules, mandatory disclosure rules, withholding taxes, availability of tax treaties, challenges to substance, anti-avoidance rules, to mention just a few.

These initiatives not only reduce operational costs but also enhance asset value and attract a new profile of investors and renters, namely the Millennial and Gen Z public, who care more deeply about environment and climatic change than previous generations.

Adopting ESG in principle should benefit both investors and stakeholders. RE companies with ESG as a north tend to show improved operational efficiency, enhanced brand reputation, and increased access to capital from the abovementioned investors, who believe that they can achieve sustainable financial returns by aligning investments with societal and environmental goals.

Investors now can support sustainable RE projects that deliver both financial returns and, it is hoped, positive societal impact. As younger generations such as the Millennials and Gen Zs already correspond to a large portion of the renters' market, and considering these two groups will progressively replace the Baby Boomer and Gen Xs in the RE market as investors, also taking into account inter-generational wealth transfer movements, it is expected that sustainability and environmentally neutral projects will become more and more of a key differential which should be highly valued by potential customers.

In view of the above, Luxembourg remains as one of the most interesting jurisdictions for structuring RE & Infrastructure investment, not only due to the wide number of possible legal forms and regimes available, but also due to its forward-looking tax & regulatory systems, constantly being refined to support and subsidize the transition to a greener economy (e.g., Luxembourg UCITS with a ESG-compliant portfolio enjoy a progressive reduction of the subscription tax, while ELTIFs are exempt from said tax as of 2023).

3. Introducing the European Long-Term Investment Fund (ELTIF)

Unlocking Infrastructure Opportunities

The European Long-Term Investment Fund ("ELTIF") is directed towards investors aiming to make long-term investments in various companies or projects. The recent amendments to the ELTIF regulations, published in March 2023, will allow asset managers to benefit from new investment possibilities which were previously restricted.

For example, the reviewed ELTIF regulations now allow investments related to RE and infrastructure, such as ports, renewable energy projects, communication networks, among others, within or outside of the EU.

In that regard, while investing in infrastructure is essential for sustainable economic growth and development, accessing capital for large-scale projects can be a rather difficult exercise. That's where the newly regulated ELTIFs could come in, providing a dedicated and readily marketable fund structure that encourages long-term investments in real estate, including infrastructure projects, and thus it is worth mentioning that by investing through ELTIFs, individuals and institutions can actively contribute to infrastructure development, driving economic growth, job creation, and sustainable progress within and outside of the EU. The current regulations at EU level should make cross-border investments more accessible, and, importantly, creating opportunities for retail investors to participate in professional real estate & infrastructure projects.

Finally, with the approval of Bill of Law no. 8183 by the Luxembourg Chamber of Deputies, ELTIFS should not benefit from a full exemption of the Subscription Tax, effectively making Luxembourg an even more interesting jurisdiction for ELTIF setup.

4. ESG and green infrastructure as RE investment drivers

Future economic growth

Environmental, Social, and Governance ("ESG") integration in the RE industry has emerged as an increasingly relevant driver of value creation.

In this context, the RE sector is being forced to embrace sustainability to mitigate its environmental impact. Developers and operators are thus implementing energy-efficient technologies, incorporating renewable energy sources, and seeking green building certifications.

To find out more about opportunities for your business in the Real Estate Sector in Luxembourg, please contact our Moore expert below.

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