CADWALADER

Navigating the Latest on Russia Sanctions – A Perspective from European Real Estate Financing

March 31, 2022

By **Livia Li**
Associate | Real Estate

By **Duncan Grieve**
Special Counsel | White Collar Defense and Investigations

It's been just over a month since Russia launched its invasion of Ukraine, and, along with the atrocities of the war hitting the headlines, a whole host of countries, led by the United States, United Kingdom and European Union, have been responding with a series of crushing economic sanctions. These measures have ranged from "blocking" sanctions, which generally prohibit any dealings with specific designated parties (and entities they own), to more limited "sectoral" sanctions, which ban some dealings with the target (*e.g.*, related to their new debt or equity). As a result, when it comes to dealing with Russia, the Russian government, and individuals linked to the Russian government, the sanctions regime has changed dramatically in a short period of time.

Between 24 February and 24 March 2022, the UK Government significantly extended existing financial sanctions against Russia to include a large number of Russian legal entities and individuals. The current list of individuals and entities targeted by asset freezes can be found on **OFSI's Consolidated List**. In addition, the UK also adopted financial sanctions which prohibit persons from dealing directly or indirectly with transferable securities or money-market instruments issued after 0:01 on 1 March 2022 by or on behalf of persons "connected" with Russia. There are also restrictions on extending loans and credit arrangements after 0:01 on 1 March 2022 to Russian legal entities and the government of Russia.

Similarly stringent sanctions have been announced by the European Union and the United States. For a summary of the current landscape of the sanctions announced in the United States, UK and European Union, our colleagues from our White Collar Defense and Investigations and Regulatory teams have published an update of the Russia Sanctions landscape which can be accessed **here**.

What does this mean for lenders for REF transactions?

Given the array of sanctions imposed, lenders around the world are no doubt paying close attention to the latest announcements in order to ensure that their compliance controls and systems remain adequate and up to date.

In the context of European real estate financing, in comparison with other financing/equity investments, given that borrowed funds are generally utilised to fund the purchase/refinancing of real estate assets located in UK/Europe, the latest changes to sanctions have a smaller impact on the existing sanctions procedures, as the asset funded is not located in a sanctioned country (in contrast to heavily affected industries such as oil/infrastructure, or investments located in Russia or owned by Russia). However, it is very important to bear in mind that with the ever-changing sanctions landscape, care must be taken with respect to the due diligence of the flow of funds and also the ultimate beneficial owner/investors, as sanctions apply beyond the simplistic view of looking only at the underlying investment.

As a general reminder, with regard to real estate financing provided for real estate investment (*i.e.*, ownership of real estate) in Europe, the asset itself is not located in a sanctioned country and so there is no restriction from a sanctions perspective with respect to the ownership of the asset unless that asset is being acquired from a blocked person − for

example, a sanctioned Russian oligarch who owns property across the continent, which may be sometimes through opaque ownership structures. The focus therefore is on the Borrower(s), the Sponsors and also the control of such persons and their use of funds. Each lender has its own sanctions policies and compliance procedures, and these are subject to different sanctions regimes. Broadly speaking, in the context of real estate financing, the matters which a lender should focus on include the following:

1. ultimate beneficial owner and control of the investor/borrower, to ensure there are no dealings with a “sanctioned person”;
2. the same applies with respect to the seller of the real estate where an acquisition is being funded – a transaction acquiring assets from a blocked person would be in breach of sanctions, and, therefore, the ultimate beneficial owner and control of the vendor should also be subject to due diligence as per point 1 above;
3. flow of funds – both inflow and outflow to a sanctioned person or territory may be subject to restrictions; this would include injection of equity, payment of distributions/dividends, etc.;
4. the Borrower must have a compliance regime/policy to comply with the latest sanctions requirements to ensure it will not breach applicable sanctions requirements;
5. the Borrower must not use the lender’s funds to do business with sanctioned parties, including by acquiring properties from sanctioned sellers; and
6. the Borrower must not repay its obligations using funds that are obtained from dealings with a sanctioned person or territory.

These are some examples of sanction covenants which are required by most lenders in providing finance. As mentioned above, due to the different compliance requirements and sanctions regimes that different lenders are subject to, the sanctions covenants may vary. As noted, any use of funds from the lender to conduct a transaction with a sanctioned person, entity or territory will be in breach of sanctions. This means that, in an acquisition transaction, the lender should screen both the borrower (purchaser) and also the seller of the asset(s) to ensure all parties involved are not subject to sanctions restrictions at the time.

From the Borrower’s perspective, it is important to ensure there are adequate sanctions compliance policies in place. The Borrower would need to be in a position, if requested by the lender, to provide information regarding ultimate beneficial owner and flow of funds. These sanctions covenants are ongoing throughout the life of the facility.

Finally, for a more in-depth discussion on this topic, our Funds and White Collar Defense and Investigations colleagues have published an article recently on this topic in *Fund Finance Friday*, which can be accessed **here.**