Real Estate

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30 OCTOBER – 4 NOVEMBER 2011

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From the Chair

Martin Holler
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This year is a very exciting one for our Section. In May, we held our 3rd Annual Conference, *'Global Investments in Real Estate'* in Miami, Florida. Phillip Skinner did a fantastic job in organising this event: 'Thank you, Phil'. I believe that everyone who was there enjoyed not only the impressive scientific programme, but also the friendly atmosphere and the unique social programme including an unforgettable Dinner Cruise through the warm Miami night. This event has really become one of the most important and most pleasant events in the calendar of many real estate lawyers. So I am very pleased that Bernat Mullerat has offered to host us next year in his home town of Barcelona, Spain. The 4th Annual Global Real Estate Conference will be held from 26–27 April 2012 and our preparations are already relatively advanced, so I can only encourage you to contact Bernat at **bernat.mullerat@cuatrecasas.com** with any questions, suggestions or proposals.

Before Barcelona, I hope to meet many of you at the Annual IBA Conference in Dubai. We have prepared numerous events for you there, including *'Offices leases for law firms – ten mistakes you can't afford to make'* (one of the very few sessions at this event that should be of specific interest to all attendees), '*Shop till you drop – a million. Shopping for shopping centres'*, *'Buying and selling distressed commercial real estate assets'* (the lead has the Enforcement of Creditor's Rights Subcommittee) and '*From desert to dessert: leisure development in MENA nations and beyond*' (lead by the Leisure Industries Section). We have also co-organised a workshop on Arab foreign direct investment in Latin America.

In addition, we will again host two almost classic events: our famous Real Estate Property Tour and our Real Estate Dinner.

If you want to get more involved with the Real Estate Section, just come to Dubai or contact our Communication Officer Izabela Zielinská at **izabela.zielinska@wardynski.com.pl**.

Gerardo Carrillo Valadez

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From the Editor

I am more than pleased to write as the new editor of the IBA *Real Estate Newsletter*. This edition has contributions from 17 different countries and I am more than confident that you will find it very interesting. One of the things I find exciting about the IBA is the opportunity to have contact with lawyers from all over the world and to be able to learn about the similarities and differences of their legal systems. So I am sure you will enjoy reading about hot topics related to real estate of very different countries through the articles in this edition.

As you will notice, Pablo Vergara del Carril and Inés Maria Poffo (Argentina) will discuss the limitations to the acquisition of rural land by foreigners which definitely is always controversial in every jurisdiction; John Corcoran and Michael Labiris (Australia) talk about the well-known Latin term *caveat emptor* in real estate transactions; Adriana Khalil Daiuto and Ana Beatriz Almeida Lobo (Brazil) also explain the restrictions to the ownership of rural land by foreigners in Brazil, starting with a historical background which I believe is always very important when we talk about rural land; Stjepan Sutija and Boris Andrejas (Croatia) talk about some recent resolutions from the Constitutional Court of the Republic of Croatia regarding the conversion of agricultural land and related matters; Natasa Aplikiotou (Cyprus) explains the recent amendments made by the House of Representatives of Cyprus in connection with real estate laws; Jakob Schou Midtgaard (Denmark) discusses a topic that we shall never forget, taxes, and this time he talks about indirect taxes while Brent Baldwin (Dubai) explains the practical implication of the Jointly Owned Property Law on hotels and branded operators in Dubai, which I believe is a great introduction to the place that will be hosting this year our IBA Annual Conference; Eddy Leks (Indonesia) writes about condominium law in Indonesia while Jean-Christophe Bouchard and Sarah Lugan (France) update us about financing French investment properties; Mustafa Motiwala (India) explains the floor space index and the transfer of development right in Mumbai and Catherine Martougin (Luxembourg) talks about alternative investment fund managers and their impact in real estate funds; Luis Moreno and Cesar Ramirez (Mexico) explain a new way of funding real estate transactions through investment trust fund certificates called Development Capital Certificates (CKDs by its initials in Spanish); Tomasz Zasacki (Poland) talks about the protection of perpetual usufruct by the principle of public credibility guarantee for land and mortgage registers under Polish civil law; while Radoslaw Biedecki (Poland) explains the new waste rules in Poland; Cătălin Grigorescu, Nicolae Ursu and Iulia Cojocaru (Romania) explain the opportunities to invest under the new PPP law in Romania; Jose Blasi (Spain) provides an overview on the new tax agreement between Germany and Spain and the possible changes in the taxation on real estate capital gains while Timur Bondaryev (Ukraine) also writes about taxation of real estate transactions under the new Tax Code of Ukraine; James Normington (UK) provides an update on easements and restrictive covenants under English law. Finally, Stephen Hubner (UK) and Kathleen Fitzgerald (Scotland) give us an explanation about sale and leaseback transactions.

I want to thank all the authors for their valuable contributions to this edition and their commitment to the Real Estate Section. Also, I want to extend my gratitude to Ed Green and his team at the IBA for all their support and help with the creation and success of this edition. I hope you enjoy reading it. Please send me any comments or suggestions you may have to improve this Newsletter. I look forward to seeing many of you in Dubai.

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Real Estate Committee sessions

30 OCTOBER – 4 NOVEMBER 2011

DUBAI

INTERNATIONAL BAR ASSOCIATION ANNUAL CONFERENCE

Workshop on Arab foreign direct investment in Latin America

Joint session with the Latin American Regional Forum, Arab Regional Forum, Banking Law Committee, Energy, Environment and Natural Resources and Infrastructure Law Section (SEERIL) and the Taxes Committee.

In the last decade, Gulf Arab countries, which also include Qatar and Kuwait, have shown their interest in some emerging markets and especially in Latin American and Caribbean countries. The main investments have been in real estate, agribusiness, port developments and energy (primarily oil and gas), among others. Latin America´s growth in real estate projects has captured the attention of Arab real estate investors who have participated as developers in diverse and important projects throughout the continent. But Arab investors have faced cultural and regulatory differences in the business community. This panel will focus on what the most common problems are and on the challenges that companies face when entering Latin America and will share their major concerns regarding the legal problems to be faced in the region.

MONDAY 0930 – 1230

Legal issues related to the creation and continuation of museums and major private collections

Joint session with the Art, Cultural Institutions and Heritage Law Committee and the Taxes Committee.

The Gulf region is currently experiencing an extraordinary surge of many new art museums and major private collections. Some of them are joint ventures with famous western museums (eg the Louvre or the Guggenheim), but many are entirely new and unrelated to any other previous institutions. New models for the management of those collections or museums, to take into account local regulations and uses, are being created or tested, and many new problems are being encountered in the acquisition, loan, import and export, restoration, reproduction, insurance and storage of artworks and other collectibles. The Art, Cultural Institutions and Heritage Law Committee has therefore put together a panel of international experts coming from important museums and private practice to examine these new problems and provide the most up-to-date solutions to them, so taking the opportunity to shape the ideal future of museums and collections management in a brand new art museum environment such as the Gulf region.

MONDAY 1430 – 1730

Office leases for law firms: ten mistakes you can't afford to make!

Joint session with the Law Firm Management Committee.

This is one of the very few sessions at the annual conference that should be of interest to almost any attendee regardless of their professional specialisation. What are the 'dos and don'ts' in office leases for law firms?

MONDAY 1430 – 1730

Buying and selling distressed commercial real estate assets – issues relating to hotels, office buildings and other commercial properties

Joint session with the Enforcement of Creditors' Rights Subcommittee, Insolvency, Restructuring and Creditors' Rights Section (SIRC).

The recent crisis has fundamentally affected investment in the real estate market. Opportunistic investment is now on the rise. New property funds and other tailor-made structures are expected to absorb distressed properties, either individually or at the portfolio level, through many different means, whether in a foreclosure, through an insolvency proceeding, or by another distressed acquisition method. These processes require specific legal expertise, providing an interesting opportunity for both restructuring and real estate lawyers to assist clients in adding value to their business. A panel consisting of experienced investors, bankers, lawyers and real estate consultants will discuss these issues and share their techniques and insights for taking advantage of these opportunities.

TUESDAY 0930 – 1230

'Shop 'til you drop – a million': shopping for shopping centres

The shopping centre industry is a mature segment of the real estate market. What are its recent economic trends? Is it still a safe-harbour investment for real estate funds? How has the shape of this industry changed in the aftermath of the recession? What is 'hot' from a legal viewpoint? What's next for retailers?

TUESDAY 1430 – 1730

Real estate property tour

The Real Estate Committee has successfully established the tradition of organising special tours of the host city of the Annual Conference. This year, an expert in the Dubai real estate market will provide an insider's look at a number of properties and developments and will provide unique information on the real estate industry in Dubai. Unlike standard tourist city tours, this afternoon event will not take you to the most famous tourist sites, but to the real hidden treasures of Dubai (as defined by real estate lawyers…).

WEDNESDAY 1430 – 1730

From desert to dessert: leisure development in MENA nations and beyond

Joint session with the International Franchising Committee and the Leisure Industries Section.

This interactive session will involve panel-based roundtable discussions of a variety of topics related to hotel expansions into the MENA (Middle East-North Africa) countries. The day-long session will be broken into a morning and an afternoon sub-session, each with its own co-sponsor committee and topic set.

The morning session will cover the real estate and financing issues presented by expansion into MENA countries. A full range of commercial development issues will be considered, with particular focus on leisure development. Discussion will likely include the continuing issue of condo hotel development and the unique challenges in the real estate realm posed by these kinds of developments in MENA countries in particular. Other current global trends in leisure property development will also be addressed.

Another major topic of discussion will be private equity, and Islamic finance and the impact that alternative finance systems like Islamic finance have on leisure developments. This portion of the discussion will be highly focused on issues in MENA countries, but will likely also address the continued expansion of Islamic finance and growth of private equity into other countries.

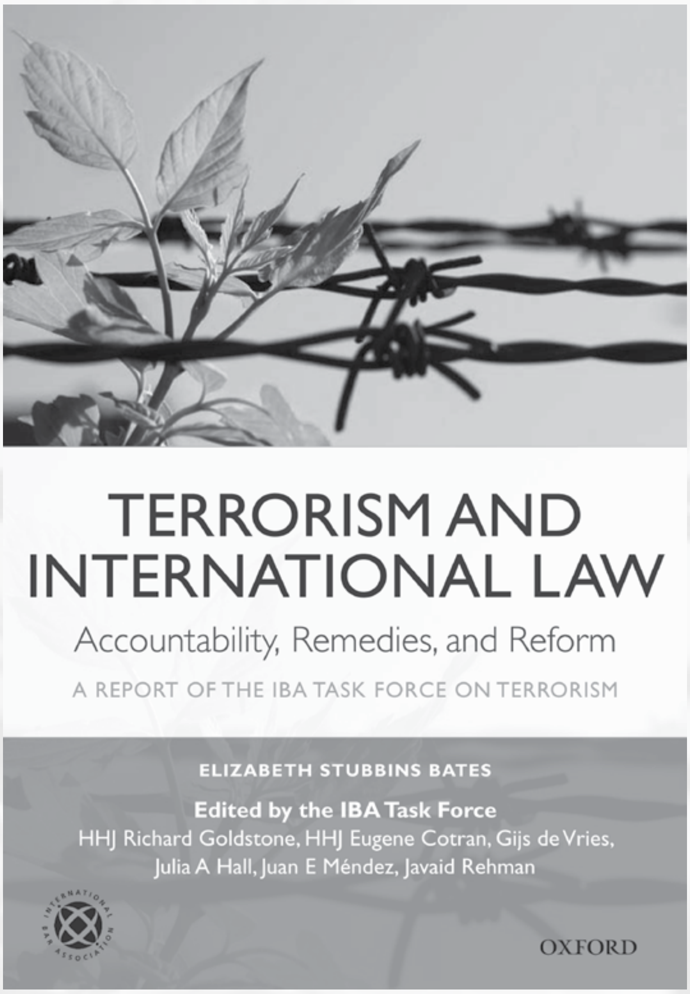
Joint session with the International Franchising Committee.

The afternoon session will look at the more operational issues that present themselves in the MENA countries, and other emerging issues in hotel and leisure property operations. One prime example will be the new trend of branded hotels, such as the Armani Hotel, focusing on tie-ins with other major, non-hotel brands in the leisure space. Other issues to be discussed are the current state of franchise laws in the MENA countries and their impact on hotel operations and hotel management agreements in those nations.

A good part of this session will take a comparative approach to analysing franchise disclosure and the viability of various management models given the particular regulatory regime in the country. The session will further explore the ability to harmonise compliance documents multinationally, and the most recent developments and difficulties in multinational operations that can result.

Terrorism and International Law: Accountability, Remedies and Reform

A Report of the IBA Task Force on Terrorism



The IBA's Task Force on International Terrorism was convened to examine the developments in international law and practice in this dynamic and often controversial area. The Task Force comprises world famous jurists and is chaired by Justice Richard Goldstone.* This book provides a global overview of counter-terrorism, including but not restricted to the US-led 'war on terror', by considering case law and examples of state practice from all continents.

*Other members: Professor Judge Eugene Cotran, Mr Gijs de Vries, Ms Julia A Hall, Mr Juan E Méndez and Professor Javaid Rehman, Elizabeth Stubbins Bates (author).

Issues covered include:

- the framework of international conventions against terrorism
- international humanitarian law
- international human rights law
- the investigation and prosecution of terrorist crimes and of international crimes committed in the course of counter-terrorism
- reform in counter-terrorism
- victims' right to a remedy and reparations

The book closes with Conclusions and Recommendations from the Task Force focusing on how the international community can ensure respect for human rights and the rule of law when responding to the threat of terrorism.

Published February 2011 ISBN: 9780199589180 Paperback
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Terrorism and International Law: Order Form

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Bill to limit the purchase of rural land by foreigners

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Introduction

In line with a trend in the region, as a result of the increasing strategic importance of commodities, on 27 April 2011 the President of the Republic of Argentina – Cristina Fernández de Kirchner – sent to the National Congress a Bill aiming to 'protect' national dominium over the property, possession or occupancy of rural lands (hereinafter the 'Bill'). It should be borne in mind that, among other natural resources, Argentina is one of the leading producers and exporters of food. The Bill – which has not yet been passed – proposes to limit the acquisition of lands by foreigners up to 20 per cent of the national, provincial or municipal territory.

Similarly, Brazil recently applied a legal criterion on the purchase of land by foreigners which gave rise to a good deal of controversy, as it limits the purchase of rural lands by foreigners to an area ranging from 250 to 5,000 hectares, depending on the region.

According to some circulating information the Uruguayan President, too, has already requested the Senators of the political party to which he belongs, to design a new law that would limit the purchase of lands by foreigners, although respecting those who are already owners.

Below is a description of the most important features of the Bill.

The bill

Definition of 'rural lands'

The Bill defines as 'rural lands' any land located outside the urban communal land, regardless of its location or destination.

Scope

Natural persons and legal entities who themselves or through intermediaries own lands for rural purposes, whether for agricultural, livestock, forestry, touristic, production or other rural uses.

Limits to the ownership of rural lands

The Bill limits to 20 per cent any ownership of rural lands in the national territory in the case of foreign natural persons or legal entities. On the other hand, the Bill provides that in no case natural persons or legal entities of the same foreign nationality will be authorised to exceed the 30 per cent of the above mentioned limit (20 per cent). Furthermore, section 9 of the Bill states that rural lands belonging to the same foreign owner shall not exceed 1,000 hectares.

For the purpose of supervision of compliance over the said thresholds, it is worth mentioning that:
- in Argentina there is a Real Estate Registry in each provincial jurisdiction;
- in order to be valid and binding the constitution, transfer, assignment and/or cancellation of rights over real estate must be in writing, notarised and registered in the relevant Real Estate Registry.

Those registries, therefore, have in their records the relevant information regarding the owners or holders of those rights.

Foreign ownership

For the purposes of the Bill, foreign ownership of rural lands is any acquisition, transfer, assignment of rights in favour of:
- foreign natural persons, whether or not they have their residence or domicile in Argentina;
- Argentine or foreign legal entities, the stock capital of which is owned (in excess of 51 per cent) by foreign natural persons or legal entities. Furthermore, the following persons are included under this paragraph:

(1) legal entities which are related to or controlled by any foreign company or cooperative holding over 25 per cent, or even when such a percentage is not reached, when the latter have enough votes to hold a majority at the governing body's meetings of the legal entity;

(2) foreign legal entities which hold an equity interest of over 25 per cent in the capital stock of another company, in accordance with section 33 of the

Companies Act (controlled companies);

(3) foreign natural persons or legal entities which, without formally proving their status of shareholders, behave in a company as if they were so;

(4) companies which have issued bonds or debentures, when such a circumstance allows the holder to increase his equity interest or convert it into stock of over 25 per cent when being foreign natural persons or legal entities;

(5) when the property is transferred by virtue of a trust agreement and the beneficiaries of the trust are foreign natural persons or legal entities of a percentage higher to that authorised under the Bill;

(6) partnerships, collaboration associations and joint ventures, when foreign natural persons or legal entities take part in them, in a proportion higher than that authorised under the Bill.

Investments For the purposes of the Bill, and taking into consideration the Bilateral Investment Treaties signed by Argentina, the acquisition of rural lands will not be deemed an investment.

Obligations

Land owners who are natural persons or legal entities with the status of foreign citizens will have to file a report with the Enforcement Authority within 180 days of the coming into effect of the Bill.

The acquisition of a rural property located in a Security Zone by a foreign person will require the prior consent of the Ministry of Domestic Affairs.

Prohibitions and penalties

The use of Argentine natural persons as 'pretended' owners in order to fulfil the ownership nationality requirement thus violating the provisions of the Bill is prohibited. Any counter-document violating the provisions of the law will be absolutely null and void and the nullity may not be reversed.

The legal instrument which allowed a person to become owner of lands in violation of the Bill will be null and void, and the nullity may not be cured. The wrongdoer and participants in the legal act will have no right to claim damages, and will be personally liable.

Registry of Rural Lands

Despite the Provincial Real Estate Registries already existing as mentioned above, the creation of a National Registry of Rural Lands under the Ministry of Justice is proposed by the Bill.

In addition, the conduct of a cadastral and dominium survey in order to determine the ownership of rural lands and to assess the status as of January 2010 is provided for.

Enforcement authority

The creation of an inter-ministries Board of Rural Lands is established. The board will be presided over by the Ministry of Justice and comprise the Ministry of Agriculture, Livestock and Fishing, the Secretary Office of Environment and Sustainable Development of the Chief Office of the Cabinet of Ministries, the Ministry of Defence and the Ministry of Domestic Affairs.

Already acquired rights

The Bill does not affect already acquired rights and its provisions will come into force the day subsequent to its publication.

Conclusion

The Bill has brought about great controversy and different opinions ranging from unconditional support to criticism. In the first group are those who see the Bill as a means to protect a non-renewable strategic resource.

Those who harshly criticise the Bill claim that its passing may imply a violation of principles of the National Constitution and the international treaties entered into between Argentina and other countries (such as investment reciprocal protection treaties).

For the time being, and according to information which has appeared in the press, the Bill has had a setback at the National Congress, since the opposition block refused to discuss it in a session shared among the Agriculture, General Legislation and Constitutional Committees. The issue will have to be considered in each committee separately, thus delaying the passing of the Bill.

Misrepresentation by silence in Australia: the death of caveat emptor?

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That the maxim of caveat emptor applies to contracts for the sale of land in Australia has never before been doubted.

Yet Australian antitrust laws and a string of cases in the last 20 years have cast doubt over the continuing relevance of the old rule. A vendor's silence may now entitle the purchaser of land to rescind the contract of sale or receive compensation.

The maxim of caveat emptor

The well-known Latin term caveat emptor is commonly translated as 'buyer beware'.

In the context of the sale of land, it reflects the old common law rule that the burden of discovering defects in a property rests with the purchaser, and the vendor is relieved from any duty to disclose facts simply because those facts might affect the purchaser's decision.

This rule has been consistently applied in Australia. For example, in one case, the purchaser discovered serious cracks in the external walls of a flat. The purchaser then sought to avoid the contract and recover its deposit. But the court refused to grant relief, notwithstanding the vendor's failure to disclose extensive engineering work that had been carried out to stop movement in the foundations (*Kadissi v Jankovic*).

Exceptions to caveat emptor

There are three long-held exceptions to the common law rule of caveat emptor.

The first applies where the vendor or agent had made express or implied statements which conveyed a false impression about certain characteristics of the property.

The second applies where the vendor knowingly disguises or conceals a physical defect in the property in order to mislead potential purchasers.

The third applies where a latent defect, flaw, fault, imperfection or irregularity in the property was not readily observable, such that the purchaser could not discover the defect through the exercise of ordinary care.

In these limited circumstances, a purchaser may be entitled to rescind a contract of sale and receive a refund of the deposit.

Misleading or deceptive conduct

Against this common law background exist Australia's antitrust laws. Section 18 of the Australian Consumer Law provides that:

> 'A person must not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.'

As cases have shown, section 18 gives purchasers a much broader scope for relief where the vendor's non-disclosure led or was likely to lead the purchaser into error.

Demagogue v Ramensky

The long-standing authority in this area is the decision of the Federal Court in *Demagogue v Ramensky*.

The case involved an upmarket property developer in northern Queensland who had obtained a licence to traverse across certain vacant land between the development and the nearest road.

By a complex set of arrangements, the developer had planned to assign the licence to purchasers of the lots.

However, when prospective purchasers enquired about the apparent lack of access, the agent merely told them: 'Well, look, of course there will be access. The developer will build a driveway up to the road.'

The court found that the developer 'had created a clear but erroneous impression in the purchasers that there was nothing unusual concerning access to the land and, in particular, had been silent as to the necessity of a grant of a licence [...] to enable such access.'

This conduct was held to be misleading or deceptive, and the purchaser had the right to avoid the contract.

New life in caveat emptor

This decision in *Demagogue* has been followed in a number of subsequent cases. But the recent High Court case of *Miller v BMW Finance* provides an interesting contrast, highlighting that the old maxim of caveat emptor is not completely dead yet.

The case involved a lender who provided funds for a borrower's insurance policy. The lender wrongly believed the policy could be cancelled, and alleged it had been misled or deceived by non-disclosure on the part of the borrower.

On the one hand, the court approved the *Demagogue* decision, accepting that silence or non-disclosure of information may constitute misleading or deceptive conduct in a variety of circumstances.

However, the judges were also careful to point out that parties of equal bargaining power are not required to 'volunteer information' to protect another party from the consequences of that party's 'careless disregard' for its own interests.

In this particular case the lender lost, primarily because the borrower had provided the relevant policy document and the lender had simply failed to read it.

Conclusion

The cases show that vendors can no longer simply hide behind the veil of caveat emptor. A vendor's silence may be penalised under antitrust law if it is, in all the relevant circumstances, misleading or deceptive.

However, the maxim of caveat emptor is not completely dead, and a purchaser of land is unlikely to obtain relief from the court where its loss is seen to be a consequence of its own careless decisions.

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Restrictions on the ownership of rural real estate property by foreigners

Historical background

Since 1971, the acquisition of rural estate properties by foreigners in Brazil is ruled by Federal Law No 5.709/71, and its regulatory Decree No 74.965/74 ('Law 5.709').

According to such legislation, the acquisition of a rural property by a foreign individual domiciled in the country ('foreign individual') and a foreign company authorised to act in Brazil ('branch') is not prohibited, but merely limited to certain caps described in the law.

The restrictions also applied to Brazilian companies in which foreigners resident abroad had the majority of the corporate capital, although such companies were supposed to be exempt since they were organised according to the laws of Brazil ('Brazilian companies of foreign capital'). Nevertheless, paragraph 1, section 1 of Law 5.709 clearly stated that 'the Brazilian company in which foreign individuals or entities have majority control of the corporate capital, by any means, are also subject to the regime established by this Law …'.

As a consequence thereof, the restrictions of Law 5.709 were applicable to (i) foreign individuals; (ii) branches; and (iii) any Brazilian companies of foreign capital.

The enactment of the Brazilian Constitution of 1988 incorporated article 171 which included a legal and constitutional level definition of 'Brazilian company'. All companies organised according to the laws of Brazil and domiciled within the Brazilian territory were to be considered Brazilian and were not to be subject to any kind of restrictions.

An interpretation of the doctrine emerged stating that, since Brazilian companies of foreign capital were considered to be Brazilian companies, the terms and restrictions of Law 5.709 were no longer applicable to such companies. The general opinion was that paragraph 1, section 1 of Law 5.709 was to be considered, *de facto,* revoked by the enactment of the Brazilian Constitution of 1988 because it included a provision that was in nature opposed to those in Law 5.709.

In 1995, the enactment of Constitutional Amendment No 6 revoked Article 171 of the Brazilian Constitution under the premise that no distinctions were to be made between a Brazilian company and a foreign company.

This amendment reintroduced the discussion on whether the restrictions imposed by Law 5.709 should become again applicable to Brazilian companies of foreign capital. The majority of the doctrine adopted the interpretation that the restrictions should not become enforceable again because:

- according to Brazilian principles of application of the law, restrictions could only be imposed by a new law; and
- after Constitutional Amendment No 6, there could not be any discrimination against Brazilian companies of foreign capital, as they were considered to be Brazilian.

As a consequence of this understanding, after Constitutional Amendment No 6, the restrictions of Law 5.709 were considered to be applicable only to foreign individuals, branches or foreign entities domiciled abroad ('foreign companies').

In order to confirm this interpretation, the AGU issued the Opinion AGU/LA – 01/97 (the 'AGU 01/97'), published in the *Federal Official Gazette* on 22 January 1999, stating that paragraph 1, section 1 of Law 5.709, was to be considered revoked as a whole, since it clearly contradicted the intentions and interpretations of the current Brazilian Constitution and even though article 171 of the Brazilian Constitution of 1988 was revoked as well, this could not restore an already-revoked section of the law.

Consequently, foreign investors wanting to acquire land in Brazil had only to incorporate a Brazilian company, which was undoubtedly a much less bureaucratic and faster method than meeting the requirements set out by Law 5.709.

However, foreign investors' increasing interest in acquiring properties in the Brazilian rural areas and the world shortage of natural resources made the Brazilian Government bring the issue of acquisition of rural properties by foreigners into discussion again.[1]

As an official justification for issuing the AGU 1/2010, the AGU referred to the existence of a worldwide food crisis and the possibility that, in the future, biodiesel may be adopted, on a large scale, as an important alternative source of energy that could have the capacity to diversify the power generation matrix of Brazil, for its own advantage.

Moreover, in an article published in the economical newspaper *Valor Econômico* on 22 June 2010, the Ministry of Agricultural Development stated 'We are going to introduce a PAC (proposal for the amendment of the Constitution) to make it clear to investors that they can invest in any field, except in lands'.[2]

In this sense, on 13 July 2010, the National Justice Council determined that the Real Estate Registry Offices should send, every three months, to the Local Internal Affairs Offices (which, in turn, will send to the National Internal Affairs Office and INCRA), a list of all acquisitions of rural properties by foreigners, whether legal entities or individuals, in their respective jurisdictions. The determination also requires the Local Internal Affairs Offices to regulate the Real Estate Registry Offices sending promptly a list of the acquisitions previously made.

On 14 July 2010 the Ministry for Development, Mr Guilherme Cassel, gave an interview in which he claimed that 'today there is no control over the purchase of land by the hand of Brazilian companies controlled by foreigners'.[3]

On 19 August 2010 the AGU issued AGU/LA 01/2010, contrary to the AGU/LA 01/97 (that has been observed for the last 13 years), in the context of several journalistic articles published in the Brazilian media whereby the Brazilian Government had indicated the need to have more control over the acquisition of rural land in Brazil by foreigners.

The AGU/LA 01/2010 simply supports the thesis that the revocation of article 171 of the Brazilian Constitution has removed any impediment to enforce paragraph 1, section 1 of Law 5.709 and, therefore, it should be now considered applicable once again.

With regard to the general public's opinion, the repercussion of the AGU/LA 01/2010 directly affects the players of the agribusiness, the pulp and paper companies, and the foreign investment funds that were acting in the Brazilian market.

The legal instruments used for the interpretation

An important issue to discuss is the fact that all these interpretations of Law 5.709 and the applicability or derogation of the restrictions to acquire rural property by foreigners is being practised by means of the AGU's Opinions and not by a law enacted by the Brazilian Congress, basically because it is a matter of interpretation of the law by federal authorities.

The AGU is mainly a legal advisor for the Executive Branch and its opinions represent the 'official interpretation' of any given issue.

Therefore, at the request of the President the AGU, invested by the powers granted by Title V of Complementary Law No. 73,[4] issued the AGU/LA 01/2010 which, with different arguments, now states that paragraph 1, section 1 of Law 5.709 is in fact in force and therefore, all the limitations contained therein to the acquisition of rural properties are from now on applicable to Brazilian companies of foreign capital.

Section 39 of Complementary Law No 73 states that only the President of Brazil may request the AGU to study any issue, and section 40 determines that an Opinion issued by the AGU, approved by the President and published in the *Official Gazette* is binding on the whole Federal Administration, including the Real Estate Property Registries.

Although AGU's opinion is not a final and binding interpretation on the public in general and therefore, its accuracy and legality may be disputed before the Brazilian courts, it is binding on all offices of the executive branch of the Federal Government.

The effective restrictions

It is important to clarify that the terms and provisions of Law 5.709 *do not prohibit foreign companies to acquire rural properties*, but establish limitations to which the acquisition of property may be made. Therefore, future businesses in Brazil may continue, taking into consideration that a new step will have to be added to the checklist of acts and documents necessary for the acquisition – the authorisation of the Government through INCRA.

Please find below a detail of the limitations provided for in Law 5.709:

(i) an authorisation by INCRA is required for the acquisition by foreign individuals of rural property with more than three and fewer than 50 rural units;

(ii) the legal limit of 25 per cent of land in the same County ('Município') owned by foreign individuals, foreign companies and/or Brazilian companies of foreign capital can not be surpassed;

(iii) the legal limit of 40 per cent of land in the same County ('Município') owned by foreign individuals, foreign companies and/or Brazilian companies of foreign capital of the same nationality can not be surpassed; and

(iv) authorisation of the Brazilian Congress is required for the acquisition over the limits of (ii) and (iii) above.

It is important to point out that in order to obtain such authorisations; a project regarding the exploitation of the rural land must be prepared by an agronomist engineer and submitted to the authorities, attesting to the economic viability of such project.

Furthermore, the Brazilian law authorises, in some special circumstances, the acquisitions by foreigners of areas larger than the maximum sizes above mentioned. For such purpose, the foreigner must present, before the National Security Council and the Brazilian Senate, a project containing information and details regarding the use of such an area. The Brazilian Senate must present its opinion based on the relevant interest of the project for the Brazilian economy and after the approval by such authority, the President of Brazil shall grant the final authorisation to the foreigner to explore such rural land, as per the guidelines of the project presented.

Note that the relevant Public Notaries and Real Estate Registry Offices are forbidden to register an acquisition made in violation of Law 5.709. If the Public Notaries and Real Estate Registry Offices do not observe the relevant legal provisions such registration shall be considered null and void and the officials concerned shall be considered civilly and criminally liable.

In a meeting held with INCRA officials last year, they stated that it was their understanding that, as an additional limitation and with regard to foreign companies and Brazilian companies of foreign capital, the size of the property shall not exceed the equivalent to 100 MEI in the Brazilian territory. Any acquisition over these limits must be approved by the Brazilian Congress.

Notwithstanding the above, considering that INCRA officials intend to apply these limitations, please find below an example of how to determine the number of hectares in the corresponding MEI. Please note that the MEI value varies depending on the State in which the rural estate property is located.[5]

Investors affected

As a consequence of the publication of AGU/LA 01/2010 the limitations and restrictions set forth by Law 5.709 will be applicable again to Brazilian companies of foreign capital, the restrictions of Law 5.709 are now applicable to:

- foreign companies and foreign individuals: who are domiciled abroad and are interested in acquiring, by any means, a rural property;
- branches: the establishment of a foreign company duly authorised to operate in Brazil;
- Brazilian companies of foreign capital: Brazilian companies organised under the laws of Brazil and domiciled within the Brazilian territory which are, in fact, an investment vehicle company of a foreign entity or individual, in which the majority of the corporate capital of the vehicle company is held, directly or indirectly by a foreign person or entity domiciled abroad.

Although it is yet unclear, the authorities of INCRA implied that it was their intent that control reaches the highest level of the corporate structure. Since the authorisation process requires that the majority shareholder of the Brazilian companies of foreign capital present their by-laws and incorporation documents, the participation of the foreign company will always be clear to the authorities and, therefore, they may require the documents of all the foreign companies until they reach the ultimate controlling shareholder.

The decentralised structures of both the Public Registries of Commerce and the Real Estate Registry Offices somehow prevented the administrative authorities from imposing the full force of the AGU/LA 01/2010 over all the investors affected and detailed above.

However, last March, the AGU requested the Ministry of Development, Industry and Trade to adopt some measures of the National Trade Registration (DNRC). This was specifically regarding the issuance of guidance directed to the Boards of Commerce of the whole territory of Brazil to take measures to prohibit the filing of any amendment to articles of association that provide any change in the corporate control of companies which own rural properties in Brazil that would imply in the transfer the control of such companies to foreign entities or foreign individuals.

The AGU has also requested of the Ministry of Agriculture, the adoption of measures by the Securities Commission (CVM) regarding the issuance of standard clauses and conditions that shall be used in commercial papers or investment agreements destined to be traded on the stock exchange, refusing the admission of securities which are not in accordance with the terms established by Brazilian law.

The AGU has argued that some listed companies might be using commercial strategies that could, indirectly, result in the acquisition of rural properties by foreign companies.

Transactions affected

In short, the acquisition, by any means, of rural estate property is subject to the restrictions determined by Law 5.709. Below is a list of the types of transactions affected by the new interpretation enforced by the AGU/LA 01/2010:

- transfer of real estate rural property by any title: whether gratuitous or paid, the transfer of a rural property to a foreign company or a Brazilian company of foreign capital;
- lease of real estate rural property: the lease and all its subspecies are also included under the restrictions of Law 5.709. Although not originally included, Federal Law No 8.629, enacted in February 1993 ('Law 8.629'), extended the restrictions of Law 5.709 to lease agreements on rural properties. Please note that the exploitation of the surface or the assets set on the rural estate property is not included under these restrictions. The legal definition of lease (rural lease agreement, '*contrato de arrendamento*') states that there is a lease when one of the parties assigns to the other party, for a determined or undetermined period of time, the use and enjoyment of a rural property for the purpose of agricultural, cattle, or agroindustrial exploitation;
- corporate transactions: by means of the provisions of section 20 of Decree No 74.965/74 the restrictions also affect any transfer of shares or participations in Brazilian companies which own rural properties, including but not limited to mergers, spin-offs, incorporations, consolidations, and basically any operation that entails a change in control of the

company owning the rural properties, when the said change in control implies the participation of a foreign company or individual domiciled abroad.

It is important to note that, when referring to Brazilian companies of foreign capital, while the terms and provisions of Law 5.709 refer to foreign companies or foreign individuals that hold the majority of the corporate capital of a Brazilian company by any means, the terms of the AGU/LA 01/2010 state that in order to equate a Brazilian company of foreign capital to a foreign company for the purpose of the application of Law 5.709, the following criteria must be followed:

- the foreign company must not be domiciled within the Brazilian territory;
- the foreign company must hold a participation, by any means, in a Brazilian company; and
- that participation must assure the foreign company the power to conduct the resolutions of the shareholders' meetings, to appoint the majority of the managers, directors or administrators of the Brazilian company, and to conduct the corporate activities and direct the day-to-day activities of the corporate bodies of the company.

This may cause an interpretation dispute since the AGU/LA 01/2010 somehow extends and bends the qualification of the foreign shareholder. If before, a Brazilian company that had a foreign shareholder holding 49 per cent of the corporate capital was not considered to be included within the provisions of Law 5.709, now, the same company may indeed be considered included within the limitations if a shareholders' agreement was executed granting the said foreign shareholder the power to control the company, although it may not hold the majority of the corporate capital.

When it comes to analysing the effects of this new interpretation in light of the ongoing transactions, please note that, some transactions, depending on their stage, shall be affected and, therefore, will have to be analysed by INCRA in order to comply with Law 5.709:

a) transactions regarding the transfer of rural properties: as per Brazilian law, the transfer of ownership of real estate property only occurs upon the registration of the relevant deed with the Real Estate Registry Office;

- If the public deed of transfer of property and required registrations have already been executed and completed with the Real Estate Registry Office before the issuance of AGU/LA 01/2010, they should not be submitted for the approval of any new governmental agency, since they are considered to be closed deals, protected under the principle of vested rights, which protects the rights constituted before the enactment of a law or norm that may affect them. We can safely state that the transactions involving rural estate properties that have been already duly registered with the Real Estate Registry Office before the publication of AGU/LA 01/2010 will not be affected by it;

  all the transactions closed and registered before the publication of AGU/LA 01/2010 (with or without the certification by INCRA of the geo-referencing) are included above. Therefore, if a rural estate property was transferred to one of the subjects affected by AGU/LA 01/2010 as detailed above and such transaction was effectively and fully registered with the Real Estate Registry Office before the publication of AGU/LA 01/2010, even without the geo-referencing, it will not be affected by the consequences arising from AGU/LA 01/2010 and such transfer will not be revoked. Please note that section 273, paragraph d) of AGU/LA 01/2010 clearly states that 'd) the effects of this Opinion must be effective as from the date of publication in the Federal Official Gazette, as determined on Article 2, item XIII of Law No. 9.784 of January 29, 1999'. The said law firmly states that within the Federal Public Administration there will not be a retroactive enforcement of a law. Note that no additional documents are required to prove that the property was duly transferred before the publication of AGU/LA 01/2010. The dating of the registered documents is sufficient to prove such fact;
- If the public deed of transfer of property or the required registrations has not already been executed and/or completed with the Real Estate Registry Office, it will have to be submitted for the approval of INCRA, since the transaction has not yet completed the legal steps necessary for the transfer of the property right (execution of the public deed of

transfer and its registration before the corresponding Real Estate Registry Office). In this case, we are talking about transactions where, at the time of publication of AGU/LA 01/2010 either (i) the public deed of transfer was not yet granted; and/or (ii) registration of the public deed of transfer with the Real Estate Registry Office had not yet occurred:

b) transactions regarding mergers, consolidation, spin-off and the transfer of interests in companies that own rural estate properties;

- If the corporate documents necessary to transfer the quotas, shares or participation interests; or the documents necessary to merge or incorporate the companies in a corporate reorganisation were granted and registered with the Public Registry of Commerce, the Registry of Shares or the Company and the Real Estate Registry (when applicable) before the issuance of AGU/LA 01/2010, these transactions should not be submitted for the approval of any new governmental agency, since they are considered to be closed deals, protected under the principle of vested rights;
- If the corporate documents necessary to transfer the quotas, shares or participation interests; or the documents necessary to merge or incorporate the companies in a corporate reorganisation were granted but not yet registered with the Public Registry of Commerce, the Registry of Shares or the Company and the Real Estate Registry (when applicable) before the issuance of AGU/LA 01/2010, they shall have to be submitted for the approval of INCRA, since the transaction has not yet completed the legal steps necessary to complete the transfer of the interests or the corporate reorganisation.

AGU/LA 01/2010 was published in the *Official Gazette* on 23 August 2010, which is the date to be considered for the analysis of the effects over ongoing transactions.

Further, it is important to note that due to the fact that ownership of rural land will be subject to prior authorisation, when foreclosing a guarantee the creditor will no longer be allowed to be awarded the property but will have to wait for its public auction (which may, in theory, affect the actual value of the property).

Authorisation process

According to information provided by INCRA, the request seeking authorisation to purchase the rural property or to close a transaction regarding a company owning rural estate property shall be submitted to INCRA, duly accompanied by the following documents:

- usual documentation related to the property;
- the corporate documents of the company interested in the acquisition;
- the project to be implemented in the acquired property.

As we have been informed, if the requesting company has a foreign shareholder domiciled abroad with majority of the corporate capital, it will be necessary to file also (i) the corporate documents of the said shareholder; (ii) a certificate of good standing; and (iii) a power of attorney appointing a representative of the shareholder who must be empowered to be subpoenaed.

The filing will be directed by INCRA to the corresponding Ministry to which the exploitation project of the rural property is related.

Despite the above, INCRA is still working on the elaboration of an internal instruction to determine the guidelines of such previous approval. Considering that the mandatory character of such a procedure is quite recent, nobody is able to ascertain how long seeking an approval may take. This is the main problem facing foreign investors.

Conclusion

The current administration seems to be very aware of the damaging effects this kind of restriction may cause to the economy of the country and, therefore, should somehow search for an escape clause to allow once again the acquisition of property without limitations although maintaining certain requirements in order to enable the Government to conduct an ongoing survey on the acquisition of rural estate property by foreigners.

On 18 April of this year the newspaper *O Estado de São Paulo* published that at least US$15bn of investments failed to enter Brazil since AGU/LA 01/2010, according to a study commissioned by the Brazilian Association of Agribusiness and Rural Marketing (ABMR&A).

According to recently published news, the Federal Government is evaluating the possibility of creating a Regulatory Agency for Rural Lands (ARTR), subordinated to the Ministry of Agriculture and Agrarian Reform, in order to inspect, monitor, control and authorise business transactions involving ownership by foreigners of rural properties throughout the Brazilian territory.

Besides that, there are certain speculations on the fact that a draft of a legislative Bill is under consideration by the Government. This would define the limits for acquisition of rural property by foreigners. The draft apparently would state that the foreign individual/company would have to incorporate a special purpose company to buy the land and offer a golden share to the Government, which would mean that the Government would be a partner in all such foreign investments. This Bill would also be foreign investment funds.

Rumour has it that the intention of Congress is not to build any barrier to foreign investments but to create an instrument of control and supervision of the state over rural land use.

The change in strategies adopted in the acquisition of property is already present in other countries of Latin America. Argentina has studies and legislative Bills to be sent to Congress to restrict the purchase of rural real estate by foreigners in order to protect the natives and limit the sales coming from foreign capital as strategic assets.

Notes

1 According to the information published by *Folha de São Paulo*, on 21 March 2011, the official personal data of INCRA noted that 45,000.00km² of Brazilian land are currently owned by foreigners, which is equivalent to 20 per cent of the area of the State of São Paulo.
2 *Valor Econômico*, 06-22-2010.
3 Estadão, 07-14-2010, National Section, p a9.
4 Enacted on 10 February 1993.
5 The value in hectares of an MEI is provided in the *Instrução Especial INCRA # 5-A* ('Instruction 5-A') dated as of 1973, which depends on the reading of the *Instrução Especial INCRA # 50* ('Instruction 50') dated as of 1997.

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Conversion of agricultural land – ten times lower charges

On 30 March 2011 the Constitutional Court of the Republic of Croatia ('Constitutional Court') rendered a decision repealing certain provisions of the Act on Agricultural Land ('Act'). The repealed provisions were regulating the following:

- grounds and terms for mandatory lease of particular privately-owned agricultural land ('Land');
- procedure and terms under which the owner of the Land ('Owner') must conduct the sale or lease of its land; and
- the charge for conversion of the land into land intended for construction purposes ('Conversion').

In general, legal rules regulating the first and second points above were repealed as the Constitutional Court found they infringed the constitutionally guaranteed right of ownership and burdened the owners excessively by encroaching on the owners' entrepreneurial freedoms in disposing of their property without apparent justification. The background for repealing the legal rules regulating the third point above resulted in some interesting consequences.

More specifically, these provisions provided for a charge for conversion of land which was:

- situated outside a construction area on the date the Act came into force and was afterwards placed inside a construction area after conversion; and
- already situated in a construction area on the date the Act came into force.

The charge was set as a certain percentage of the average price of land inside a construction area. The percentage of the charge for land under the first point above was set at 100 per cent (for land treated as valuable) and 50 per cent (for land treated as not valuable), while the percentage of the charge for land under the second point above was set at five per cent (for land treated as valuable) and one per cent (for land treated as not valuable). The Constitutional Court found those provisions regulating the charge for land under the first point above unconstitutional due to considerable disproportion in the treatment of the owners in relation to the charge for conversion of land already situated in a construction area on the date the Act came into force. The reasoning of the Constitutional Court was that a differentiation of the owners was based upon factual circumstances the owners could not have influenced. One of those circumstances was the classification of the area in which land was situated on the date the Act came into force. The other was the future changing of zoning schemes by the local authorities inducing conversion of land into land for construction purposes. Consequently, such regulation of charges for land conversion set up in percentages of 100 per cent and 50 per cent created inequality among the owners on the basis of their property. This was found to be unconstitutional.

Soon after the decision of the Constitutional Court was rendered, the Croatian Government (Government) enacted amendments to the Act. The amendments provide for a ten-times lower amount of charge for conversion of land in order to comply with the constitutional requirement of equality. Consequently the charge for conversion of land which is outside a construction area amounts to ten per cent (for land treated as valuable) and five per cent (for land treated as not valuable) of the market price of land situated in a related construction area.

The above changes provoked reaction in numerous associations in Croatia engaged in environmental protection. These associations argued that a ten-times lower charge for the conversion of land would be an opportunity for speculation and corruption in the preparation of zoning documents. The zoning rules, inducing conversion of land, would be tailored in a manner to benefit certain owners who would buy land which would afterwards be converted to more expensive construction land. Consequently the conversion of the land would be more feasible and thus might cause devastation of land. Similarly, the Croatian Ministry of Public Administration stated in its opinion on the amendments that such a lowering of the land conversion charge would enable speculation with land.

Future developments will reveal whether the amendments were enacted hastily and whether predictions of numerous associations and Ministry of Public Administration were well founded.

Planning amnesty in Cyprus

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General information

After many years of discussion the House of Representatives has finally approved important amendments regarding the Town and Country Planning Law, the Streets and Building Regulation Law and the Immovable Property (Tenure, Registration and Valuation) Law. The new legislation came into force on 8 April 2011 aiming to simplify and modernise the procedures which lead to the issuance of new updated title deeds by the current property owners. This progress brings to an end a long period of difficulties and obstacles experienced by numerous property owners because of the non-issuance of proper certificates of registration regarding their properties by the Land and Surveys Department. This was due to many reasons, some of which were related to the need for legalisation of minor building irregularities.

The main developments of the amended legislation

Most of the amended provisions are of a temporary nature and are characterised by simplicity and accuracy leading eventually to the legalisation of strictly specified irregularities over existing buildings based on their nature, scale and significance while particular conditions are applicable. The main developments which came into force are as follows:

- an accurate application has to be submitted to the Building Authority followed by a detailed description of the concerned building for which the certificate of registration is sought and the existing irregularities which are contrary to the building or planning permit issued in the past;
- an updated title deed regarding a building may be issued notwithstanding the existence of any irregularities which in any event will be reported on it;
- however, the latter does not automatically result to the legalisation of the concerned building given that the competent authorities have the right to take certain measures against the property owner in order to comply with all the obligations which come out from the relevant legislation and the issued permit;
- the number of parties which are empowered to commence the established procedures regarding the issuance of an updated title deed are expanded including not only the owner but also the purchaser and the competent authority. Therefore, in the event that the owner is unwilling to comply with his obligations the procedure may be invoked by any of the other parties;
- the updated title deeds may be issued in the name of the purchasers only in the event that the original owner consents, otherwise they are issued exclusively in the name of the original owner. What is worth mentioning is that with regard to large developments it is possible for separate title deeds to be issued concerning separate individual units;
- the imposition of administrative fines is provided in all three laws against any owner who is reluctant or unwilling to commence the procedure for the issuance of an updated title deed or who does not proceed with the procedure.

In conclusion, it is expected that applications will be submitted regarding the issuance of updated title deeds by hundreds of property owners who have been waiting for this development to occur over the last decades so that they can obtain titles and by owners fearing the threat of heavy administrative fines for failure to do so.

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Indirect taxes – back to basics and opening of new frontiers

The aftermath of the financial crisis has globally left the real estate industry struggling to regain stability and in most jurisdictions we have seen a surge towards old school asset management skills and optimisation of the performance and value of the assets. In Denmark we have over the last two years experienced the banks putting a lot of emphasis on who they are lending to and whether the lenders are skilled and professional property investors and/or owners. In the eyes of the financial institutions it seems that the Danish real estate industry demonstrates that it can prosper not only when the market is driven by increasing prices, but also in a more steady and stable market where values are created by optimisation of the performance of the assets. From a legal point of view this has led to an increased number of assignments related to optimisation of assets, lease contracts, cash flows etc and this tendency is spreading to areas such as indirect taxes, which can have a significant impact on the performance of assets.

In addition to specialising in traditional indirect taxes related to transaction costs such as stamp duty, the number of assignments related to indirect taxes are growing and today we see increased competition between law firms on the one side and auditors, consultants, asset managers etc on the other with respect to advice on such indirect taxes as property tax, VAT, service taxes, utility costs etc.

At the same time globally we experience the introduction of a number of new indirect taxes which will lead to even more focus on advice related to indirect taxes.

The introduction of new VAT rules on the transfer of property in Denmark has accordingly led to a large number of seminars, newsletters, direct marketing etc related to VAT from all categories of advisors in the real estate industry and this will very likely be the offspring to a similar process with respect to other direct and indirect taxes such as eg property tax, utility costs, fees related to connection to the electricity grid, water supply, etc.

With a VAT level of 25 per cent and an annual property tax of one per cent per annum interest from potential clients is understandable.

To compete in that field with eg auditors, accountants and other consultants there will be a need for law firms to adjust to new market mechanisms and means of selling and cross-selling at such new frontiers.

Equally, renewed focus on green buildings, green lease agreements, solar facilities in connection with real estate projects and government supported environmental schemes have led and will lead to a need for law firms to specialise in and fully understand government aided support programmes, energy supply regulation and contracts, etc. Historically, law firms have not been front runners with respect to advice on similar matters, but the current trend with focus on asset optimisation will in my opinion imply that law firms throughout the globe must specialise in similar cash flow supporting programmes.

There seems to be a move back to basics, but also with new frontiers.

The impact of the Jointly Owned Property Law on hotels and branded operators in Dubai

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The practical implications of the Dubai JOP Law on hotel developers and branded property operators

In brief:

- the manner in which the Jointly Owned Property Law and the Directions impact on hotel mixed-use developments is a particularly topical issue for Dubai considering the number of such developments here and because there can be a number of competing interests in such developments;
- although a hotel owner may have a very large individual entitlement due to the size of the hotel for example, the residential owners may collectively have more entitlements than the hotel owner;
- if control of common areas is handed over to an owners' association with no interest in meeting the contractually agreed standards, the owner of the branded component may be required to pay additional charges on top of any service charges levied by the owners' association in order to maintain such standards.

In little over ten years, Dubai has grown from a relatively unknown fishing and trading port to arguably one of the world's (or at least the Middle East's) most sophisticated cities. Despite recent stories in the media about the 'downfall of Dubai', it appears that no one has told this to the people living here. From the personal experience of the writer of walking around Dubai's malls, beaches and hotels it seems Dubai remains an extremely attractive destination for holiday makers, those looking to establish a commercial presence in the Middle East or North Africa region and people wishing to settle here.

It is well-known that over the past decade fortunes have been won and lost through property speculation in Dubai. Easily available credit, huge investment in worldclass infrastructure and the construction of high profile developments such as the Palm Jumeirah combined to create a huge real estate boom. The purpose of this article is to consider some of the real estate laws that have been introduced to regulate the real estate market in Dubai, and in particular the 'hotel mixed-use' developments that help make Dubai a prime holiday destination for its many thousands of visitors each year. Many of these developments include freehold apartments for residential living or which are placed back into a hotel letting pool or both, and it is interesting to consider the impact of recent legal developments on this segment of the Dubai hotel and leisure market.

Considering the amount of foreign investment in Dubai over the past decade, particularly in the residential apartment and villa sector, it may surprise some to know that it was only in 2006 that the Government formally introduced regulations specifying areas in which foreigners could obtain title to freehold property. Although there was no specific restriction on this previously, it was customary practice that only UAE citizens and citizens from countries included in the Gulf Cooperation Council could be registered as owners of land in the UAE.

Although there had previously been a land registry in place, it was nowhere near as well-developed as one would find in some other jurisdictions that are popular for real estate investment. This led in 2007 to a new Land Registration Law being introduced that made provision for a more specialised land registry with jurisdiction over all Dubai land including 'designated investment areas for foreigners', and included a more formalised land registration process and rules supporting the concept of freehold property ownership. These laws were only a small part of a raft of property related legislation that was introduced within a relatively short space of time between 2007 and 2010.

A significant number of large scale residential, villa and mixed-use hotel/residential/commercial developments were being built at this time. Given the relatively undeveloped state of the real estate laws, there was always an element of uncertainty regarding who was responsible for managing the common parts of such developments. Although the laws made it clear for example, that investors could own a freehold unit in an apartment building, there was a need for further clarity regarding the rights and obligations investors had in relation to lifts, foyers, swimming pools, gyms, gardens and other 'common' areas and facilities, and how owners could collectively be responsible for running and paying for them.

The usual mechanism to provide for this was for owners to enter into a contractual scheme, and for the developer to take responsibility for the related management and administrative matters and levy service charges on owners with in many cases, limited legal oversight for how this was done. This led to many claims from owners that developers were over-charging and making a profit from service charges, and based on anecdotal evidence it appears many developers had relied on their ability to run these developments and levy service charges with a profit component to help support their cash flow.

This occurred despite the fact that approximately five years ago, the Dubai authorities started considering an appropriate legal regime to apply to such developments and began consulting with advisers from overseas jurisdictions where jointly owned property (often known as 'strata') management regimes were commonplace. This ultimately led to the issuance of Law No 27 of 2007 concerning Ownership of Jointly Owned Properties in the Emirate of Dubai (JOP Law) in December 2007. The JOP Law was broadly based on the equivalent Australian legislation, and sought to put in place a statutory regime to level the playing field with respect to service charges and clarify issues relating to the ownership and management of jointly owned properties and the common areas and facilities that form part of them.

Although the JOP Law created ripples in the market (for example it led to a number of owners' association management companies setting themselves up in Dubai), the JOP Law was subject to implementing Directions without which it had no real impact. It was not until early 2010 that a number of Directions were issued to effect the implementation of the JOP Law.

The manner in which the JOP Law and the Directions impact on hotel mixed-use developments is a particularly topical issue for Dubai considering the number of such developments here and because there can be a number of competing interests in such developments. Owners of residential units may not have the same desire to see common areas maintained to the high standards required by a hotel, for example.

Yet for hotels, the overall presentation of the development is an important aspect in attracting and retaining patrons. In addition (and depending upon any contractual restrictions), hotels may wish to regulate permanent residents' use of common areas in a number of ways, such as by charging for the use of swimming pools and gyms, or putting rules and procedures in place for the use of foyers, valet and concierge facilities.

The JOP Law and Directions place responsibility for the management of the common areas onto owners through the creation of a registered owners' association and an elected board, with voting rights determined by each owner's 'entitlement'. Although a hotel owner may have a very large individual entitlement due to the size of the hotel, for example, the residential owners may collectively have more entitlements than the hotel owner. This means that owners of apartments in hotel mixed-use developments may find themselves with a degree of control over a commercial hotel owner or operator. There are a number of possible consequences of this, including potential impact on the valuation of the hotel, making the hotel less marketable to an institutional investor and a hotel management company or a lender not receiving the certainty they require that their investment will not be subject to the dictates of an 'outside' group of owners, whose interests may not be the same.

The JOP Law and Directions have sufficient flexibility to regulate these matters, but developers need to consider the boundaries of what is acceptable to the Dubai Real Estate Regulatory Authority (RERA), which is the authority responsible for implementing the JOP Law. It is RERA's policy that everyone is assumed to have the same rights under the JOP Law, and RERA has stated that it is unlikely to accept (no matter how justifiable it may be) one particular owner in a development having a greater degree of control of common areas and facilities than others, for example by artificially adjusting voting rights.

Developers and owners who have an interest in promoting a hotel or serviced apartment brand will need to carefully consider how these issues are dealt with in the governing constitutional documentation for the building. If, for example, a hotel or other brand is not maintained to its historical standard, it is possible the brand may suffer or the brand owner may terminate rights of use. Developers need to work closely with RERA in these matters to be mindful of what was and was not promised in the sales documentation and what the buyer bought into. Owners that bought in with the expectation of the development being maintained to a very high standard as part of a distinct brand may not object to those standards being reflected in the governing constitutional documentation. There may however, be developments where residential owners do not share these concerns and who may object to such high standards being enforced and consequently reflected in their service charges. Once a developer completes an assessment of these issues, the manner of enforcing the particular standard needs to be carefully considered and appropriately reflected in the governing constitutional documentation. This creates a need for creative thinking by lawyers and others advising developers in this area.

Developers also need to consider the basis on which they have contracted with a hotel or other branded operator. If control of common areas is handed over to an owners' association with no interest in meeting the contractually agreed standards, the owner of the branded component may be required to pay additional charges on top of any service charges levied by the owners' association in order to maintain such standards. This could have a detrimental effect on profits. Developers also need to consider what services or facilities were contractually agreed to be provided for owners and whether hotels or other branded operators can charge owners for the benefit of those services or facilities.

It is important that these issues are properly considered by a developer and reflected in the governing constitutional documentation. Owners have rights to amend significant parts of the constitutional documentation by a two-thirds majority vote, so proper consideration of these issues on the basis of achieving fairness and equity between the different interests in a mixed use development will reduce the chances of unfavourable changes being sought by owners later.

Dubai has very quickly grown from a quiet backwater to a sophisticated city and in many cases its laws (and in particular the JOP Law and Directions) have gone from being simple (or non-existent) to very comprehensive and technical by UAE standards. Many market participants may find issues associated with the application of these laws to be complex to grapple with, and there remain many questions regarding how the JOP Law and Directions are going to impact the market in the medium and long term.

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Financing French investment properties

On 8 March 2011, the French Supreme Court ruled on the *HOLD* case. The decision rendered jeopardises the validity or at least the efficiency of the standard security packages usually implemented by financial institutions when they grant a loan to special purpose vehicles dedicated to the owning of property.

The *HOLD* case relates to the holding and the financing of the French building 'Coeur Defense' and the consequences for the various lenders of the collapse of Lehman Brothers. Indeed, when the collapse took place, the creditors requested new counterparts, and the borrowers answered by placing themselves under the protection of the French legislation on bankruptcy, allowing them to challenge the execution of the security packages.

The creditors claimed that such protection should not be allowed because the borrowers were merely owning the property without qualifying as carrying on a business and moreover they had no employees. As a result, according to the creditors, the borrowers were not entitled to benefit from the protection of the legislation on bankruptcy, the latter aimed at protecting businesses and not passive ownership of properties.

However, the French Supreme Court decided that the borrowers could benefit from the protection of the bankruptcy legislation, and accordingly could deny the execution of the security packages. Indeed, the scope of the legislation is the situation of financial difficulties of any legal person under private law. In conclusion, although the purpose of the legislator was clearly to protect businesses and not persons merely owning properties, the French Supreme Court decided that the scope should prevail on the purpose, since the drafting of the law was not ambiguous, so that there was no need for interpretation of the purpose of the law.

In this context, financial institutions must look for more security when financing or refinancing a property or portfolio. Of course, there are solutions allowing them to obtain a satisfying security package, even in the new context, but it is clearly necessary to analyse the situations on a case-by-case basis. The most efficient solution is the implementation of financial leases, where the creditors directly own the properties, so that there is no need to execute any security. Other solutions require eg the interposition of a holding company exclusively funded with equity and granting a pledge on the shares of the legal entity owning the property to the creditors; since the company granting the pledge has no debt, there is no risk that the execution of the pledge could be denied. Other intermediary solutions are available.

FSI and TDR in Mumbai

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FSI (Floor Space Index) rules and regulations were introduced in Mumbai in 1964.

Rule 2(3)(42) of the Development Control Regulations for Greater Bombay, 1991 (DCR) defines Floor Space Index (FSI) as the quotient of the ratio of the combined gross floor area of all floors, excepting areas specifically exempted under these regulations, to the total area of the plot:

$$\text{FSI} = \frac{\text{Total covered area on all the floors}}{\text{Plot area}}$$

FSI is the ratio between the built-up area allowed and plot area available (FSI = Total Covered Area on Floor ÷ Plot Area). If FSI is 1 then on a plot of 100 square metres, one can build 100 square metres of built-up area and with setbacks (area of the land between the front building line and street alignment) and open spaces, the building can be higher than one floor. In uncomplicated language, the higher the FSI, the higher is the built-up area. Mumbai city is divided in two parts: (i) island city and (ii) suburbs. According to the provisions of the DCR and other authorities the island city has an FSI of 1.33 and the suburbs have an FSI of 1. The State Government has drafted a policy for FSI applicable to the state of Maharashtra. It varies from city to city and municipality to municipality depending upon the population density.

TDR is a three-letter acronym that produced a concrete jungle in Mumbai and stands for Transferable Development Rights.

Rule 34 of the DCR defines TDR as: In certain circumstances, the development potential of a plot of land may be separated from the land itself and may be made available to the owner of the land in the form of Transferable Development Rights. These rights may be made available and be subject to the Regulations in Appendix VII of DCR.

Broadly speaking TDR is the development potential of the land (benefit arising from land), which was suspended because of the reservation of land in the Development Plan for Mumbai by the Government of Maharashtra to be acquired for public purposes (reserved land). In order to avoid the payment of heavy compensation and the lengthy proceedings involved, the Government found an exclusive way of compensating the landowner under which the development potential of the land is detached from the reserved land itself, the land stands transferred to the Government and, in return, the development rights, equal to the development potential attached to the reserved land, are transferred to the owner, to be used in some other land as per the provisions of DCR. The owner of the reserved land is thus compensated by additional FSI which can be used on some other land over and above the normal FSI permitted in relation to that piece of land. These detached rights are known as TDR, which are formalised by the issue of Development Right Certificates (DRC) by the municipal commissioner. The owner of such DRCs can transfer them like a negotiable instrument for valuable consideration if he himself is not inclined to exploit DRCs in his own properties.

If a property developer surrenders his plot of land and offers to build homes free of charge for slum dwellers or those displaced due to infrastructural projects, he gets proportionate property development rights northward of that plot. He can then sell the property so developed on the open market. The TDR was to be an incentive for builders to construct homes for the underprivileged. It is an extra right used to make rehabilitation projects possible. If the FSI of plot is too small, it is possible to get some development rights as TDR, to be transferred to that plot or to a more northern area pursuant to the provisions of DCR. This led to sudden, haphazard and unplanned development in the suburbs. The city activist and former builder, Bhagwanji Raiyani, founder of NGO namely Jan Hit Manch, filed a public interest litigation in the Bombay High Court asking for a total ban on TDR. The Honourable Bombay High Court passed an interim order banning the use of TDR along the Eastern and Western Express Highways and the Eastern and Western suburban railway tracks.

Further, the Bombay High Court cleared the decks for corridors along the Western and Central railway lines. Because of this order the city's largest builders benefited and the suburbs became even more congested than they are now: *Janhit Manch v/s State of Maharashtra* [2007] (2) ALLMR 110.

In 2010, the Government of Maharashtra introduced an additional FSI of 0.33 that could be purchased from the Government for properties located in suburban Mumbai but that has been stayed by the Bombay High Court. Though developers can still avail themselves of an FSI of two, the loss of the option to buy from the Government will mean that developers are entirely dependent on market purchases of TDR. Earlier, the Government order meant that apart from the inherent FSI of one and 0.67 FSI that could be purchased from the market, the developers could buy 0.33 FSI from the Government to be able to provide a built-up area of FSI of two. Now to achieve an FSI of two the owner/developer has to buy TDRs entirely from the market. This will result in increased demand and price for TDR. Eventually, it means an increase in the cost of projects, resulting in an increase of real estate prices. The sale and purchase of TDR is a market phenomenon. The prices of TDR are variable depending on the location of TDR generation and the location of TDR deployment. Thus, there is a degree of uncertainty in pricing of the TDR in the market. The Government of Maharashtra has drafted a policy for the use of TDR governed by the provisions of DCR Appendix VII. Appendix VII lays down the rules for the grant of TDRs to owners/developers and conditions for the grant of such rights. Based on the intensity of development, the city is divided into intensively developed (A-zone), moderately developed (B-zone) and sparsely developed (C-zone) zones in the plan. The TDRs shall be from intensely developed zones to other zones and not *vice versa*.

The Government of Maharashtra is in process of modifying certain norms in the existing DCR which will boost the Mumbai real estate scenario.

Note

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Condominium law in Indonesia

Background

Condominium law in Indonesia is governed under Law Number 16 of 1985 on Condominium ('Condominium Law'). This law is already in force since its enactment on 31 December 1985. The Condominium Law is very simple. It consists of only 26 clauses. This Condominium Law has not been revised or revoked. However, the House of Representatives together with the Government are preparing a new draft of the law which was planned to be enacted early this year. Unfortunately, with many issues and problems in relation to the management of condominium in Indonesia, especially issues between the developers and tenants, this new law has not been issued yet.

Principal understanding

A condominium is defined as a vertical building, divided into units which are structured functionally – horizontally and vertically – that can be owned and used separately, especially for residence, supplemented by common facilities, common equipment and common land.

The main difference between condominiums and other properties in Indonesia is the concept of common ownership: of common land, common facilities and common equipment. When a condominium is built on land, the land will be called common land since all the owners of units of strata title in the building have shares over the land.

What is common land? Common land is land used under an undivided common right, where a condominium is built over it, determined in accordance with the building licence. A common facility does not form part of an apartment, but is jointly owned for common use. Examples of this are parks, landscaping, social buildings, religious buildings, parking spaces and playgrounds. Common equipment is a part of an apartment that is undividedly owned for common use, in a unified function of an apartment. Examples of this are foundations, columns, walls, floors, blocks, roofs, stairs, lifts, pipes, electricity systems, gas, telecommunications and public areas of an apartment.

Requirements of a condominium

Development of a condominium has to comply with technical and administrative requirements. These requirements include the building structure, security, safety, health, comfort, and any other items related to the design, including the facilities and its environment. The administrative aspect will include the business licence of the development company, the location licence and/or the use of land, and the building licence. A condominium can only be built over with the right of ownership, right to build, right of use of State land and right of management.

Ownership of a condominium

A condominium can be owned by an individual or legal entity that has fulfilled the requirements as holder of right of land. Condominium ownership is ownership of a unit which is individual and separate. Condominium ownership includes ownership of common land, common equipment and common facilities where all are the integral and inseparable parts of the unit. The right of common land, common facilities and common equipment are based on the area or the value of the related condominium at the time that the condominium was owned by its owner.

As the evidence of ownership, the owner will have a certificate of right of ownership over the condominium or a certificate of right of ownership over strata title unit. The right of ownership of the condominium may be transferred by inheritance or any other transfer of rights in accordance with prevailing laws. This may include sale and purchase, exchange and bequest.

Encumbrance

A condominium can be encumbered with hypothec – a right established by law over property belonging to a debtor. It can also be encumbered with *fiducia*, if the land is in the form of right of use. This provision has not lbeen used since the enactment of Law Number 4 of 1996 on Mortgage (*Hak Tanggungan*) (Mortgage Law). In the Mortgage Law, the right of ownership, right to build and the right of use can be directly encumbered with mortgage. The hypothec and *fiducia* encumbrance concepts for the land are no longer used.

Tenancy and management of a condominium

A condominium which has been built can only be sold to be occupied once the developer has obtained the occupancy feasibility licence issued by the related regional government. This licence is required for the issuance of the certificate of right of ownership over the condominium. This licence also applies for a non-residence condominium. The licence guarantees the security, safety, comfort, and order of the tenants, and is very important because the Condominium Law regulates that if this licence has not been obtained by the developer, there will be a criminal sanction applied of up to ten years' imprisonment or a fine of up to Rp 100,000,000 (one hundred million Rupiah).

Condominium tenant association

The tenant of a condominium is obliged to establish a condominium tenant association. The developer must facilitate its establishment. The condominium tenant association shall be given a legal entity status. As a legal entity, the organisation structure, rights and obligations will be regulated in the articles of association and by-laws. The main task of a condominium tenant association is to manage the common interest of the owner and tenant in relation to their ownership and tenancy in the condominium. A condominium tenant association has the right to appoint a building manager to implement the management including supervision on the use of common land, common facilities and common equipment and their maintenance.

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The European Alternative Investment Fund Managers Directive: How will it affect managers of real estate funds?

Setting up a real estate fund is a complex task which must combine the appropriate determination of real estate assets on the basis of investors' preferences and consideration of managers' experience and real estate market trends. From a tax and legal perspective, multiple constraints also have to be combined with a view to preserving the interests of the investors, of the promoter and of the asset manager of the fund.

Following the 2008 downturn in the worldwide economy, this task will become even more difficult with the increase of regulatory constraints. This has affected the US since the entry into force of the Dodd-Frank Act passed in July 2010 but also Europe with the adoption of the European Directive on Alternative Investment Fund Managers (AIFMD) adopted through the trialogue process in November 2010.

Indeed, the recent international crisis revealed certain flaws in the international financial system which led governments and multinational organisations to review in depth the regulatory and supervisory frameworks for all the actors of the financial markets. In Europe, it appeared that unlike the industry of undertakings for collective investment investing in transferable securities which is harmonised and highly supervised, the industry of alternative investment funds was mainly managed by actors which were not subject to any supervision.

One of the initial factors of the 2008 crisis was the financing of real estate properties in the US and the refinancing thereof on financial markets via so-called sub-primes. Managers of real estate funds, in managing their portfolios of real estate assets, have not been identified as responsible for the downturn. However, it appeared that the actions of managers of such alternative assets, with significant amounts in invested assets, were not without effect on the scale of the financial crisis or without impact on the worldwide economy.

Accelerating the legislative reform that had already been contemplated a few years before, the G20 during its meetings in November 2008 and April 2009 urged the legislators to prepare new legislation to cope with the lack of transparency, the weaknesses of risk management and asset safe-keeping arrangements and the inadequacies in due diligence processes.

Within a very short period of time the European Commission proposed the first proposal directive on alternative investment fund managers aimed at imposing a closer regulatory oversight of systemic risks emanating from the activities of the managers and the funds of the alternative investment sector. After eighteen months of difficult negotiations and frequent criticism of the alternative investment funds industry, the Directive on Alternative Investment Fund Managers of 8 June 2011 has been adopted (AIFMD).

It will be implemented into the national legislation of each Member State of the European Union by July 2013 together with a substantial number of implementation measures. What are the key elements of this piece of legislation and what impact will it have on the managers of real estate funds?

What are the objectives of the AIFMD?

As from July 2014 further to the implementation of the AIFMD into national legislation, all managers managing real estate funds or marketing European or non-European real estate funds shall be required to obtain an authorisation and will be subject to on-going regulation and supervision.

The AIFMD is intended to:

- increase transparency towards investors, supervisors and employees of the companies in which the funds invest;
- develop the powers of national and European supervisors to enable them to monitor and respond to risks to the stability of the financial system caused or amplified by the activity of such managers;
- increase the protection of investors;

- reinforce the single market by increasing investors' choices and competition under high and consistent regulatory standards; and
- increase the accountability of managers holding controlling participations in companies toward employees and the public.

Will all real estate fund managers be submitted to the provisions of the AIFMD?

In view of the European legislator's 'one fits all' approach, the AIFMD encompasses all managers in the alternative investment fund industry including managers of real estate funds (AIFM). Indeed, the AIFMD incorporates:

- all European AIFM which manage one or more alternative investment funds (AIF), irrespective of whether the AIF is an European AIF or a non-European AIF;
- all non-European AIFM which manage one or more European AIF; and
- all non-European AIFM which market one or more AIF in the European Union, irrespective of whether the AIF is an European AIF or a non-European AIF.

All other criteria which are usually used to define funds will be irrelevant. In particular, it has been made clear that it is of no significance:

- whether the AIF belongs to the open-ended or closed-ended type;
- whether the AIF is constituted under the law of contract or under trust law, under statute or has any other legal form; and
- what the legal structure of the AIFM is.

As long as there is a link between a manager or an alternative investment fund and the European Union, the manager which is managing or marketing such alternative investment fund may be subject to the provisions of the AIFMD.

Numerous real estate funds may fall within the scope of the AIFMD as such assets are not eligible for UCITS. Funds investing in real estate are typically considered to be alternative investment funds within the meaning of the AIFMD.

However, not all real estate funds will fall within the scope of the AIFMD. Several investment structures commonly set up in Europe or abroad would not correspond to the definition of an AIF and/or will fall under the exemptions provided for under the AIFMD.

Indeed, an AIF is defined as any collective investment undertaking, including investment compartments thereof, (a) which raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and (b) which does not require authorisation under the UCITS Directive.

Excluded are vehicles which do not raise funds from third parties such as family office vehicles, joint venture and 'club deals'. The AIFMD shall also not apply to the management of pension funds, employee participation or savings schemes, to supranational institutions, national central banks or national, regional and local governments and bodies or institutions which manage funds supporting social security and pension systems, nor to securitisation special purpose vehicles or insurance contracts and joint ventures.

The AIFMD also provides for certain exemptions for managers in charge of smaller funds. An exemption is granted to any manager managing one or several AIF, which are not leveraged and without redemption rights for a period of five years and with assets under management below €500m. Also exempted are managers managing one or several AIF whose assets under management are below €100m.

Managers in charge of existing closed-ended funds may benefit from grand-fathering provisions if such AIF do not make any additional investments after the transposition deadline of the AIFMD into national legislation or if the subscription periods of those AIF closed prior to the entry into force of the AIFMD in July 2011 and their term expires at the latest in 2016. In such cases, they shall not be submitted to authorisation requirements but only to certain disclosure and registration obligations.

What are the main features of the new regime for real estate managers under the AIFMD?

Each real estate manager falling within the scope of the AIFDM must be authorised as an AIFM by the supervisor of its home Member State (i.e. where its head office and registered office are located) or the Member State of reference for non-European managers.

Such authorisation shall be granted only if the manager demonstrates that:

- it has substance in terms of capital and own funds, the minimum of capital being €125,000 for external AIFM and €300,000 for self-managed AIF and the amount of own funds available to cover potential liability risks arising from professional negligence should be equal to one quarter of the AIFM overhead costs and 0.02 per cent of the AIF portfolio values in excess of €250m (capped at €10m subject to insurance coverage allowing a 50 per cent reduction);
- the persons effectively conducting the business of the AIFM and the shareholders or members of such entities are suitable;

- a program of activity setting out the organisational structure of the AIFM has been produced;
- remuneration policies have been put in place;
- proper arrangements have been made for the appointment of a depositary; and
- information on the contemplated delegations has been provided.

When authorised, the AIFM shall be allowed to perform investment management functions involving at least portfolio management and risk management. They shall be authorised in addition to perform other functions such as administration, marketing and other activities related to the assets of the AIF.

The AIFM shall comply with a comprehensive set of rules of conduct:

- Conflicts of interest between the AIFM and its managers and employees and the fund(s) managed by the AIFM must be identified and organisational arrangements must be implemented to prevent, manage and monitor such conflicts of interest.
- The AIFM must establish and maintain remuneration policies and practices for those categories of staff whose professional activities have a material impact on the risk profiles of the fund(s) they manage.
- The AIFM shall be required to functionally and hierarchically separate the functions of risk management from the operations units, including portfolio management.
- Leverage ratio must be disclosed and limited taking into account the type of the funds, their strategy, the sources of their leverage, the relationship with financial services institutions that could pose systemic risk, counterparty exposure and the extent to which the leverage is collateralised. The supervisor shall have a controlling power over these leverage limits and may request such ratio to be adjusted should they appear unreasonable or likely to contribute to risk affecting market integrity.
- The AIFM shall be required to apply appropriate liquidity management systems and procedures, including the conduct of stress tests under normal and exceptional circumstances. Investment strategy, liquidity profile and redemption policy must remain consistent at all times.
- The AIFM shall be required to designate an external depositary for each fund it manages, it being in charge of the supervision of the assets of the fund.
- The AIFM shall be required to establish appropriate and consistent procedures in respect of each AIF they manage to ensure that a 'proper and independent' valuation of the AIF's assets can be performed in accordance with applicable national rules and/or with such AIF's rules or constitutional documents.

The authorisation obtained in one Member State shall be valid in all Member States provided that the conditions of the AIFMD are complied with on a continuous basis. To benefit from this European passport, managers of AIF who do not fall within the scope of the AIFMD may opt in.

What will the impact be on the real estate fund industry?

By July 2014, the managers of real estate funds falling within the scope of the AIFMD must comply with the provisions of the transposed legislation of the Member State of their domicile or the Member State they have elected should they be a non-European manager.

For certain managers, the adaptation to the new legislation will be minimal as the AIFMD replicates certain best practices of the real estate funds managers already operating under the supervision of national regulators. For managers of real estate vehicles which are not operating under any supervision, there will be an important mutation to be operated.

The AIFM legislation will increase the operating costs of real estate funds notably due to the new capital requirements, the obligation to designate external depositaries and external valuers and on occasions the substantial internal reorganisation required within the manager to cope with new compliance and reporting obligations. It is expected that it will point forward towards further consolidation in the real estate fund industry. European passporting will benefit the largest real estate managers which will benefit from economies of scale by consolidating their European entities throughout Europe.

Similar authorisation and registration of managers of such alternative funds will be required with the Securities and Exchange Commission of the US. Bearing in mind that large numbers of managers of alternative investment funds are domiciled in the US and in Europe, all managers active in the historic financial places will be subject to substantive regulatory requirements including regular reporting to their supervisors and investors.

Promoters and initiators of real estate funds will have to identity the jurisdictions that will allow them to accommodate their business models in the most efficient manner and to ensure the constant attractiveness of their real estate funds for investors.

Development Capital Certificates (CKDs): the bet for financial recovery of the real estate market

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Introduction

The real estate industry in Mexico, following that in the US which sparked the global economic downturn in 2008, struggled to recover in 2009 and 2010, but with little success, and the path to a full return to health is littered with land-mines that could send the sector spiralling downward again, possibly upending the nascent economic revival. The light at the end of the tunnel were the Development Capital Certificates (CKDs), the subject matter of this article, which we hope will help fuel the real estate industry and put it on track for a slow, but steady recovery in 2011.

General overview of CKDs

In mid-2009, the Mexican National Banking and Securities Commission (CNBV) (*Comisión Nacional Bancaria y de Valores*) published new rules providing for public offerings of investment trust fund certificates called CKDs (*Certificados de Capital de Desarrollo*). These rules now permit CKDs to be listed on the Mexican Stock Exchange (BMV) (*Bolsa Mexicana de Valores*). The CKDs are new investment instruments structured as equity funds to finance specific ventures, such as real estate related projects, infrastructure, highways, ports, mines, railroads, power generation and technology etc.

Introduction of CKDs in the Mexican securities market was only possible because the federal government, through the National Commission for the Retirement Savings System (CONSAR) (*Comisión Nacional del Sistema de Ahorro para el Retiro*), proposed a change in the investment regime that applies to SIEFORES (*Sociedades de Inversión Especializada en Fondos para el Retiro*), the investment arm of the federally regulated Mexican pension funds AFORES (*Administradoras de Fondos para el Retiro*). Such a change allowed SIEFORES to invest in a wider range of variable return securities, including CKDs, for the purpose of fostering investment in long-term projects, with special focus on infrastructure projects, including those related to real estate.

The new rules for Mexican pension funds are significant because the total net assets under management in voluntary and compulsory pension systems in Mexico equal an approximate Mx$1,039bn pesos (which is equivalent to US$83bn at Mx$12.5 pesos per dollar). Thus, pension funds represent an important potential market for investments in CKDs.

The main goal of CKDs is to help reactivate the Mexican economy by generating investment and employment, and minimising the adverse effects of the global financial crisis in Mexico.

The Internal Regulation of the BMV (the 'Regulation') defines CKDs as investment trust fund certificates which are issued by Mexican trusts for a specific period of time, with uncertain and variable returns, partially or totally linked to the underlying assets which are held in the trust and which comprise the trust assets. It is important to note that the issuer of the CKDs has no obligation to repay the principal or interest. That is, the instrument is linked to the success of the infrastructure project, in this case, the real estate projects where the money obtained from their placement is invested, and its returns are derived from the dividends or sale of shares, as underlying trust assets.

In a nutshell, CKDs are hybrid instruments which may include debt and capital. As we mentioned, they grant their holders the right to variable income arising from the projects and/or companies where the liquidity stemming from their placement is invested.

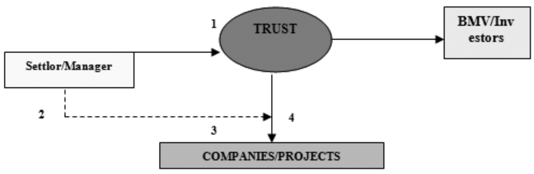
In accordance with the Regulation, CKDs may be classified according to the type of investment, in:

1. CKDs type 'A', intended for investments in equity securities or in the purchase of goods or rights derived from the cashflow of various companies; and
2. CKDs type 'B', intended for investments in equity securities or in the purchase of goods or rights derived from the cashflow of one single company.

Structure

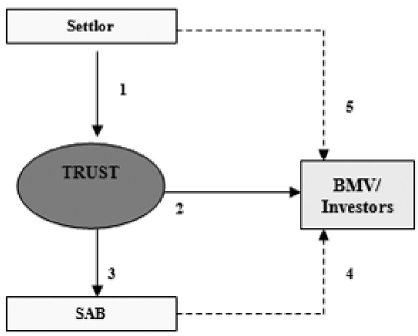
As applied to real estate financing, type 'A' may carry out 'investment schemes' in several vehicles (trusts and companies) that own underlying real estate properties of a commercial, industrial, residential or combined nature including hospitality. Such CKDs generally require a manager of the various real estate projects the subject matter of the investment. Type 'B' may carry out 'project schemes' and adopt investment alternatives among the different types of real estate portfolios that are to be owned by the special purpose vehicle used to hold title to the assets.

Type A
Investment Scheme



1. An irrevocable trust agreement must be created for the purpose of (i) setting the rules to finance the project/s, the company/companies or the structure similar to a private equity fund; and (b) issuing the CKDs to obtain resources from its public offering to later invest it in the vehicles that hold the different real estate portfolios or properties.
2. The settlor may contribute any kind of real estate assets to the trust (the settlor and the manager may be the same entity), including a combination of commercial, residential, or industrial real estate related properties.
3. The trust and the settlor/manager execute a services agreement for the management of the trust's assets. The trust will hold the assets/rights contributed by the company or the project seeking financing, and the resources obtained through the public offering of the CKDs.
4. The trust will invest pursuant to the instructions issued by the manager in multiple special purpose vehicles or projects.
5. Parties acting as managers include sophisticated real estate funds such as AMB, PREI and others or individuals with experience in the field that have joint ventured with funds or other type of financing entity and are interested in investing and helping to manage real estate portfolios.

Type B
Investment Scheme



1. The settlor must adopt the regime of a *Sociedad Anónima Promotora de Inversión Bursátil* (SAPIB) *or Sociedad Anónima Bursátil* (SAB).
2. The trust issues the CKDs.
3. The trust invests all of the funds it collects in a sole company which may be the settlor or the company that carries out the real estate project.
4. The SAB lists its shares at the BMV. The settlor may be the same SAB subject to the investment.
5. The settlor must amend its by-laws to include the administration and surveillance regime of a public/listed corporation (*Sociedad Anónima Bursátil*) and prepare a programme to adopt the complete regime of an SAB, through an initial public offering within three years.

As defined above, CKDs programs are structured through the establishment of an irrevocable Mexican trust that issues CKDs for their placement on the BMV. CKDs are targeted at domestic and foreign institutional/qualified investors (eg, Mexican pension funds, or AFORES, but also permitting foreign investors to participate). The settlor of the trust, who is usually the manager of the underlying assets, uses placement funds to acquire different investment opportunities, which are usually shares of special purpose entities that own a real estate project or a property, or that will develop a real estate project or acquire a property which the manager is interested in investing in and considers a good investment opportunity.

Every CKD represents to its holder the right to collect dividends, capital reductions, redemptions of shares representing the capital stock of the special purpose vehicles in which the manager invests, including the manager itself. On the sale or disposal of the shares or other securities issued by the grantor, upon maturity of the CKDs ie, on the expiration of the programme, all real estate investments are liquidated and the CKDs are paid back to their holders together with an expected return on their investment. Note, however, that CKDs, as equity investments for a predetermined period, are securities with no nominal value, so there is no obligation on the issuer trustee, grantor, or common representative, to pay principal, interest and/or any return/yield under a CKDs programme. This is because, as explained, the payment derives from the financial performance of the underlying project/business, which is mainly generated from income earned from sales to third parties relating to the underlying real estate project. Thus, CKDs are not rated by any rating agencies, because risk does not depend on the issuer's payment capacity, but rather on the earnings generated by the underlying assets (ie, the trust assets). For a CKD programme to be approved, certain due diligence over the investment plan by the party acting as manager needs be carried out and its feasibility approved by specialist consultants, which currently include the Boston Consulting Group.

The purpose of using the trust as issuer of the CKDs is to ensure that funds obtained from their placement will be invested in the underlying real estate related shares/projects according to the investment regime that each of the CKDs programmes needs to include, and to ensure that any costs and/or expenses of the placement will be paid out of those funds. In addition, any shares or assets contributed by the grantor of the CKDs programme will become part of the trust assets.

CKDs may be guaranteed through a security interest on the trust assets, usually a pledge over the shares of the special purpose vehicles that hold the underlying real estate projects. The grantor must list those shares with the National Securities Registry (*Registro Nacional de Valores*) as an SAPIB or an SAB so that a pledge on the securities (*prenda bursátil*) can be granted over the shares. In fact, pursuant to the Regulation there is an obligation to register the shares as a requirement for issuing CKDs (ie, the CKDs may be placed only if their underlying assets are shares of an entity which is a SAPIB or a SAB).

The authority vested in the trust's technical committee includes the ability to approve any future real estate projects pursuant to an independent expert's feasibility opinion (committee members representing at least 25 per cent of the committee will be independent members from the project companies and its grantor).

CKDs in existence

To date, there are 15 CKD programmes approved by the CNBV and listed on the BMV. The public offerings amount up to MX$38.3bn (real estate: 25 per cent; infrastructure: 53 per cent, and private equity: 22 per cent). The real estate market now expects new issuances of pending CKDs placements, which will happen later this year. The CKDs have surprised the national economy and will impact, positively, on the infrastructure development and other sectors in Mexico. The market predicts that the rest of 2011 will show its capacity of sustaining improvements and growth in this area through the use of CKDs as the main form of real estate financing in Mexico, injecting the capital that the industry was otherwise desperately trying to obtain with little or no luck.

Conclusions

CKDs have become very relevant for the recovery of the real estate and infrastructure industry, as they cover a segment of the Mexican financial system which had not been used before in this country but which had been used with success in other international markets. Prior to its appearance, only traded debt securities and, to a lesser extent, the placement of equity, were used as financial instruments alternative to traditional bank credits.

As already mentioned, there is a great expectation that continuing to use CKDs as an instrument could greatly expand the stock capital infrastructure and real estate development in our country. The new challenge developers face will be related to the professionalisation of its transactions in order to attract capital through the issuance of this type of instruments.

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Is the acquisition of a perpetual usufruct fully protected by the principle of public credibility guarantee for land and mortgage registers under Polish civil law?

The principle of public credibility guarantee for land and mortgage registers

Land and mortgage registers in Poland are maintained to determine the legal status of real estate. Title to real estate as well as encumbrances, easements and mortgages are registered in the land and mortgage register through entries made by the court. Land and mortgage registers are publicly available and it is thus not possible to plead ignorance of entries registered therein.

Land and mortgage registers guarantee certainty of legal transactions involving real estate rights.

The principle of the public credibility guarantee of land and mortgage registers (the Principle) is defined in the Act on land and mortgage registers. Briefly, this provides that a purchaser acting in good faith acquires legal title or other proprietary right by entering into a transaction with a person who is registered in the land and mortgage register. The Principle protects persons acting in trust in relation to the land and mortgage register. A consequence of the Principle is that upon acquisition of the ownership or other proprietary right, the right of the legitimate owner (not entered in the land and mortgage register) expires and the purchaser effectively acquires this right.

Perpetual usufruct

Perpetual usufruct is the second strongest proprietary right after ownership. It is established for a period of 40–99 years. It is fully transferable, can be encumbered and inherited. As a proprietary right, it is enforceable against all parties. The perpetual usufructuary is the owner of buildings that are built on the real estate. Perpetual usufruct is quite popular in Poland, especially in cities where vast amounts of land belong to local municipalities or to the State Treasury. Many property development projects are carried out on real estate which developers hold on perpetual usufruct. The same relates to industrial properties. It has to be emphasised that according to article 232 of the Civil Code, perpetual usufruct can only be established on real estate which belongs to the State Treasury or the local municipality. It is therefore not possible to establish a perpetual usufruct on real estate which belongs to private individuals or entities. This provision is fundamentally important to understanding the problem outlined below. Reference to the State Treasury shall mean jointly the State Treasury and the local municipality.

The problem

For years, doctrine and case law have disputed whether the Principle applies to the acquisition of perpetual usufruct where the State Treasury was improperly (erroneously) entered into the land and mortgage register and therefore was not the real estate owner. Since it was not the real estate owner, it was not possible to establish a perpetual usufruct on this real estate. This is because, and it must be reiterated, binding provisions of civil law provide that a perpetual usufruct may only be established on real estate which belongs to the State Treasury. Thus a dispute continued about the extent to which the Principle applies and the legal effects thereof in relation to State Treasury property rights. The issue was whether the Principle should prevail, or whether the rule that perpetual usufruct cannot be established on real estate other than that belonging to the State Treasury should exclude the application of the Principle in such cases. Proponents of the absolutely binding Principle argued that the Principle protects certainty of legal transactions and protects a purchaser who in good faith acquires the relevant right in the course of a legal transaction. They asserted that the Principle sanctions the legal status in the land and mortgage register over the actual legal status. Deviation from this absolutely binding Principle would undermine the certainty of legal real estate transactions.

Proponents of the second point of view argued that on the basis of the Principle it is not possible to acquire a right which from the outset could not have arisen. They further argued that acquisition of a perpetual usufruct in such a situation would lead to division of ownership between the State Treasury and the actual owner since the perpetual usufructuary would bear obligations toward the State Treasury including fees where the State Treasury was not the real estate owner.

After major changes in the Polish political system in the late 1980s, a wave of proceedings claimed invalidity of the State Treasury's title as a result of nationalisation, expropriation and similar legal instruments introduced after the Second World War. In all cases where the State Treasury's good title has been queried and undermined, the question arises whether the Principle protects persons who, whilst acting in good faith, acquired perpetual usufruct from the State Treasury where the latter was registered as the owner in the land and mortgage register. Various rulings were handed down by the courts.

The Supreme Court resolution

The Polish Supreme Court recently held that the Principle also protects the acquirer of a perpetual usufruct in the event of an erroneous entry of the State Treasury as the real estate owner. This resulted from a Supreme Court panel of seven judges hearing a legal issue which had been passed to it by the Supreme Court while examining a particular case. In its justification, the Supreme Court shared the view that the rule stemming from the Act on land and mortgage registers that third parties participating in legal transactions in good faith are protected, and the rule on security of conducting legal transactions, prevail in particular conditions over the constitutional principle of protection of the ownership right. The Supreme Court held that strengthening these rules in the conduct of legal transactions requires the intensification of legal protection for a person who acquires perpetual usufruct acting in trust in relation to the land and mortgage register. An interpretation which expresses this assumes the occurrence of two basic legal consequences of the Principle. The first and basic one is the acquisition by the purchaser of a perpetual usufruct from an unauthorised party. A secondary effect is the State Treasury's acquisition of title to real estate. Hence, acquisition of the perpetual usufruct by a person protected by the Principle occurs in such legal form and configuration of entities (the perpetual usufructuary – State Treasury) in which the perpetual usufruct appears in legal transactions. Acquisition of ownership by the State Treasury constitutes a secondary and derivative effect guaranteeing the fullest legal protection of a third party (purchaser of the perpetual usufruct) acting in trust in relation to the land and mortgage register. Assumption of acquisition of ownership of land by the State Treasury merely constitutes a secondary legal consequence of the operation of the Principle, which is indispensable for guaranteeing appropriate legal protection for the perpetual usufruct. Such protection is manifested not only in the actual acquisition of perpetual usufruct, but also through relevant configuration of property right relations between the perpetual usufructuary and the State Treasury.

Comment

This resolution has no special legal force which would bind Supreme Court panels ruling in similar cases in the future, but considering the authority of the Supreme Court it will contribute to consolidating court rulings.

I believe that the resolution will strengthen the view that the Principle should broadly apply as a fundamental rule shaping certainty in legal transactions and that it cannot be limited in its application. It will also help in curbing the mistrust of investors, particularly foreign investors, as to the certainty of legal title to real estate provided by perpetual usufruct.

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New rules in waste management

Poland is not acceding to the European Directive of 26 April 1999 (1999/31/EC) on waste storage. According to the Directive, Poland should by 31 December 2010 have limited the amount of stored biodegradable waste to a maximum of 75 per cent of such waste produced in 1995. The country is not complying with the permitted volume and faces potential fines by the European Commission. More figures speak for themselves: by 31 December 2013 Poland should have limited the storage of biodegradable waste to 50 per cent and by December 2020 to 35 per cent of the 1995 amount. In 2011 Poland produced 12 million tons of waste and Warsaw alone 800,000 tons. Most of it is deposited in waste depots.

On 1 July 2011 the Polish Parliament addressed the issue of timing deadlines and the possibility of fines. It adopted an amendment aimed at requiring all communes to achieve the targets. The amendment is awaiting the President's signature.

Private waste collection companies operating in Poland, many of them controlled by foreign investors, control almost 60 per cent of the market and have entered into millions of agreements with waste producers (individual real estate owners or production facilities). The new rules will have a direct impact on their business.

How should it work from 2012?

Communes will become, by operation of law, the owners of waste produced by households and shall control waste management in their territories. This will bring about communalisation of waste and a potential redistribution of contracts among the private companies in the waste collecting sector.

Commune shall appoint under a public tender the waste collection and treatment company. If communes dealing with waste collection would consider participating in such a tender, then they need to be transformed into commercial companies.

New tax

The communes shall charge the real estate owners a waste management fee to cover collection, transportation, recovery and recycling costs. Communes shall freely determine whether entrepreneurs active on their territories shall be subject to such services or whether the entrepreneurs shall enter directly into agreements with waste management companies. The provisions of the Tax Ordinance shall apply to the waste fee and the communes shall benefit from strong legal instruments to collect the new tax.

The amount of the 'waste tax' will be fixed by each commune by way of a council resolution. The waste tax for a given real estate shall be determined taking into consideration:

- the number of inhabitants; or
- the house/apartment living space; or
- the volume of water used.

The idea is to pay for the actual waste produced in a household and not for a theoretical or declared volume.

What happens if the service of waste collection is not performed properly or at all? Should the real estate owner claim compensation from the commune or waste collecting company?

Those questions remain open.

Infrastructure issues

A commune or group of communes listed in the *voïvodship* waste management plan shall erect and maintain waste treatment plants. The same document shall contain the localisation of new waste treatment plants. Communes, waste collecting companies and marshalls of *voïvodship* shall deliver reports describing the tasks performed. Such a solution should help in eliminating illegal and uncontrolled waste depots.

The communes, as owners of waste, will be able to secure enough raw material for waste treatment plants combined eg, with heat producing facilities. This does not happen at present. Experts consider that to be one of the key reasons why PPP projects in the waste management industry did not get involved.

Also in connection with the infrastructure issue, the communes shall choose by public tender the investor for the waste management facility. There is a legal obligation to invite tenders only once. If that is not successful, then the commune shall be free to invest itself into such a facility. So another question arises: will the attractiveness of structuring waste treatment plants under a PPP model significantly increase or will the communes prefer to keep this activity with a potential 'privatisation' option in the future?

Opportunities for private investors created by the new Romanian PPP Law

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On 4 November 2010 Romania passed Law No 178/2010 on public private partnership ('PPP Law') after more than four years' absence of a specific legal framework in this domain. During those years, public private partnerships ('PPPs') were possible only on the basis of the legislation regarding the contracting of public works and the concession of services. The new legal framework introduced by the PPP Law has made possible the setting up of companies to be jointly owned by a private investor and a public authority. PPP Law was subject to various controversies and this is why the adoption process was delayed several times.

The establishment of a specific legal framework through the PPP Law was intended to eliminate existing inconveniences in Romanian legislation, which either burdened or impeded access of investors to certain domains (for example road and hospital infrastructure).

The PPP Law is intended to provide to central and local authorities an alternative means of financing their projects. Rules are established for the initiation and performance of public private partnership projects for public works in various domains of activity with private financing. However, currently, the provisions of the PPP Law seem to overlap other legal provisions in the fields of concession of land, public works and services and public procurement, so it is not clear to which contracts the PPP Law shall apply.

According to explicit provisions included in the PPP Law, the law shall not apply to joint ventures, to contracts currently governed by the Government Emergency Ordinance No 34/2006 regarding the concession of services and public works and to contracts currently governed by the Government Emergency Ordinance No 54/2006 regarding the concession of public assets. The PPP Law will apply only to other types of contractual arrangements which could be entered into by public authorities. Nonetheless, the areas in which further types of contractual arrangements to which the PPP Law could apply without being in conflict with other Romanian legal provisions is very narrow, as it is likely that the projects to be concluded might conflict with the well-defined regime of the goods from the public domain of the public authorities. For this reason the PPP Law or certain provisions thereof might be declared unconstitutional.

The main advantage of the PPP Law in comparison with the concessions legislation consists in the possibility that the scope of a PPP project may be achieved by a specially established project company, having as stakeholders the public and the private partner. The contribution of the public partner to the share capital of the project company is limited to contributions in kind as the public partner is not allowed to make payments to the private investor/s financing the project.

This aspect has raised a series of criticisms from the private sector, thus drawing the attention of public authorities and non-profit and non-political organisations promoting the business community in Romania. The PPP Law appears suitable mainly for projects that can generate revenues themselves, a fact that may be discouraging for private investors. Given that the PPP Law would seem to exclude availability payments to the project company, investors must be very confident that the project will produce enough revenue to cover the costs of the investments and to generate profit.

Nonetheless, PPP projects, as regulated by the PPP Law, bring undeniable benefits, such as:

- the increase of efficiency in the implementation of projects;
- the possibility of benefiting from the know-how of the private sector;
- the possibility of financing more projects;
- the allocation of risk between the public partner and private partner;
- the enhancement of the investment environment.

Additionally, upon publication the PPP Law provided that the PPP project shall be initiated by the public partner, who shall analyse and select certain private investors, with which it shall further negotiate and finally conclude the PPP contracts. The PPP Law has been criticised by the European Commission in consideration of the uncompetitive procedure of awarding the contract to a private investor on the basis of an expeditious negotiation procedure contravening European procurement legislation. The entire awarding procedure was amended in April 2011 under pressure from the European Commission. Currently the methodological norms are under scrutiny by the European Commission.

Although several months have passed since the PPP Law entered into force, no project has been implemented or initiated under the new legal framework. It is expected that the above-mentioned inconveniences related to the PPP project financing shall be removed in the near future, thus allowing private investors to access the real estate sector in Romania using PPPs and their indisputable benefits.

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New tax agreement between Germany and Spain: will there be changes to taxation on real estate capital gains?

In a press release dated 3 February 2011 it was announced that the governments of Germany and Spain had signed, in a German-Spanish summit, a new Convention for avoiding double taxation, for clarifying the needs arising from economic and business relations between Spain and Germany and the subsequent changes introduced to the OECD Model Tax Convention.

When it becomes effective, the new Convention will replace the one signed in Bonn on 5 October 1966. It will enter into force three months after exchange of the ratification instruments although the provisions will apply from 1 January of the following year. Therefore, if the agreement is ratified in the near future, it is expected that the modifications will become applicable from 1 January 2012.

A very significant change in this new Convention is in the article relating to capital gains taxation with the introduction of real estate anti-abuse provisions.

Because of this, capital gains arising from the sale of shares or stakes in companies, the main assets of which relate directly or indirectly to real estate located in Spain or Germany, shall be correspondingly subject to taxation in Spain or Germany, starting from 1 January 2012.

The concept of 'real estate' shall be understood in line with internal definitions provided by each country: in Spain, photovoltaic panels and wind farms are considered real estate.

Additionally, the new Convention modifies both the regulations applicable to partnerships and the mechanisms for avoiding double international taxation particularly in Germany.

Will there therefore be changes to taxation on the direct or indirect sales of real estate located in Spain or in Germany?

This matter will have to be looked into. The announcement of the entry into force of this new Convention offers, without doubt, opportunities for tax planning.

Taxation of real estate transactions in light of the new Tax Code

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A number of legislative innovations in Ukraine occurred on 1 January 2011. In the opinion of many experts, the most significant was the entry into force of the new Tax Code – the first attempt in the history of Ukraine to codify tax legislation – which can be estimated quite differently, has many pros and cons and has a huge impact on the entire economy of the country.

In addition to codifying existing rules, the legislator's attempt was a completely new approach to taxation of certain transactions which, significantly affected the real estate sector. The Tax Code clearly demonstrates the legislator's keen attention to real property taxation and to taxation of proceeds from real estate transactions. The experts working on the Tax Code carefully studied current tax practices having regard to the appropriate assets and proceeds, and took steps to increase the tax burden or introduce new taxes. This article will analyse the basic and most significant changes in real property taxation.

Real estate tax (property or wealth tax)

Prior to the Tax Code, owners of real estate assets were not regarded as property taxpayers; landowners and tenants paid a land payment in the form of land tax or rental payment (see below the section on Land tax). It should be noted that the real estate tax as a type of tax was originally envisaged in article 14 of the Law of Ukraine On Taxation System but its introduction was constantly delayed.

According to the Tax Code the real estate tax shall be introduced on 1 January 2012, the date on which the unified all-Ukrainian system of property rights registration is expected to come into force. The coincidence is apparently to be explained by the necessity to ensure the monitoring and enforcement of the tax payments, as there is no unified property registration system at present.

Taxpayers

Taxpayers are individuals and legal entities, including non-residents – owners of the properties.

Tax base

The object of taxation is residential property only. We suppose that the legislator introduced the tax based on the assumption that taxation of commercial properties shall be imposed by taxation of the proceeds derived from its use.

The tax base shall be the residential or living (not total) area of the respective facility.

If the taxpayer owns several real estate properties the tax base shall be calculated with respect to each individual one.

According to the Tax Code the tax base is reduced by a living area of 120 square metres for an apartment and by 250 square metres for a residential house. That benefit is available once a year on one property in which a natural person is registered or at the taxpayer's discretion in respect to any other property owned.

Thus, for instance, a person will be tax exempt if it owns a residential property, an apartment with a total area 250 square metres but having a living space not exceeding 120 square metres.

However, a person who owns three apartments each with a total area of 200 square metres and a living space of 130 square metres, will be required to pay tax on 270 square metres (130 x 3 - 120).

Tax rate

Real estate tax is a local tax, which is why the tax rate determination has been entrusted to local governments (local councils).

For apartments with a living space not exceeding 240 square metres and houses with a living space not exceeding 500 square metres, the tax rate per one square metre cannot exceed one per cent of the minimum wage established by law as of 1 January of a reporting (tax) year.

For apartments with a living space exceeding 240 square metres and houses with a living space exceeding 500 square metres, the tax rate per one square metres shall be 2.7 per cent of the minimum wage established by law as of 1 January of a reporting (tax) year.

Considering the currently effective minimum wage (UAH960 as of 1 April 2011), one can see that the tax amount is not really impressive (one per cent - UAH9,6 = approximately €0.85).

In general, the increased tax burden on property owners, in our opinion, is a positive trend that will have a significant impact on the market and will bring about lower prices of assets and trigger a flow in the real estate segment. Today, property and landowners can afford to hold assets for a long time, speculating in them and hoping to get the most coveted consumer who will pay what the property owner asks. It is not a secret that real estate had been the only object of investment for individuals and legal entities who hoped for a rapid value increase. This was the case before worldwide financial crisis. Given the insignificant maintenance costs of facilities in most cases, the tax *per se* does not exist or is paid (in the case of land) in small amounts, the owner can afford to ignore such minor expenses without rushing into a sale.

We are of the opinion that a property tax introduction will force landlords who own numerous residential properties to think of selling or renting them to cover the ongoing tax costs. At this stage of the real estate sector development this could be considered a positive trend, provided the tax amount is set at an adequate level, with a clear differentiation of tax rates with respect to the property destination and the owner's status ie, whether the property is its principal place of residence or an object of investment (speculation).

According to the logic of the Tax Code, a person owning only one residential property, which is his/her primary residence, should be tax exempt. At the same time, those owning multiple properties and using them for speculative purposes or for obtaining a regular income should pay more taxes on the respective property.

Personal income tax

Taxation of rental income

Another significant positive innovation of the Tax Code is the change of the taxation structure in real estate transactions, in particular, regarding the proceeds derived from renting out and selling real estate.

Before the entry into force of the Tax Code, the rental income of residents was taxed at the rate of 15 per cent and at a double rate (30 per cent) for non-residents.

According to the Tax Code the tax rate to be applied to rental income is unified for both residents and non-residents and amounts to 15 or 17 per cent (depending on the taxable amount), which can be viewed as a positive signal and will be appreciated by foreign investors.

It is important to note that property owned by a non-resident individual is to be rented out exclusively through a local tax agent. Failure to meet the requirement is considered a tax evasion and is subject to prosecution.

Taxation of proceeds from sale (exchange) of real estate

In accordance with the 'old' legislation, income from the sale of real estate was taxed at a special reduced rate, namely one and five per cent, respectively, or totally tax exempt in case the transaction is the first residential property sale of a taxpayer within the year, provided the total area of the property to be sold does not exceed 100 square metres. The income of non-residents was taxed on a similar base. The disposals of non- residents' properties were subject to specific taxation rules which were different from those applying to residential sales.

Pursuant to the provisions of the Tax Code, the legislator has defined the principle of tax exemption on the first sale of residential property, regardless of its area (thus excluding the 100 square metres limitation). However, an additional qualification has been introduced. In order to benefit from the tax-free disposal of residential property, the seller must be the owner of the property for at least three years at the moment of sale.

Disposals of any other (non-residential) properties, as well as of the second (or more) residential properties within one year, are subject to taxation at the rate of five per cent for Ukraine residents. For non- residents the 15 (17) per cent rate applies.

Taxation of inherited property or gift property

Income received in the form of property from first-degree relatives is not subject to taxation (0 per cent rate).

The five per cent rate applies to a person's income in the case of an heir who is not a first-degree relative.

The rate of 15–17 per cent applies in a case when a non-resident is involved.

Income received as a gift shall be taxed in the manner set out above.

Reporting requirements for realtors

A new regulation was introduced by the Tax Code which has a significant and very symbolic impact on the real estate advisory industry. Persons engaged in brokerage activities related to renting out properties (realtors) are obliged to report to the tax authorities respective information on the transactions concluded with their assistance. Apparently by this step the state wants to avoid potential tax evasions. As the brokerage activity in the property sphere is not regulated ie, is not subject to mandatory licence or certification, this is the first step in controlling the business.

Value added tax (VAT)

There are no VAT changes in the taxation of real estate transactions according to the new Tax Code. In particular, VAT-exempt are transactions on supply (sale, transfer) of land plots, except for those that are under properties, which price is included in the total transaction value according to legislation.

Rent for public (state or municipal) land plots is VAT-exempt. The rental payments for private land plots are subject to VAT.

Property acquisition transactions (asset deals) are subject to VAT.

It is important to remember that the shares acquisition of a Ukrainian SPV (property holding company) (share deal) is also VAT-exempt making that transaction attractive from the tax point of view even if it involves a higher volume of transactional work (legal due diligence, financial due diligence, merger control, SPA-structure etc).

Tax rate

The Tax Code provides for a reduction in the VAT rate to 17 per cent as of 1 January 2014. The current rate is 20 per cent.

Pension fund contribution

Acquirers of property in Ukraine have paid pension fund contributions for many years. This continues under the Tax Code. The pension fund contribution rate amounts to one per cent of the contractual value (it applies solely for property acquisition, transaction but not for land acquisition, transactions).

State (stamp) duty

The state duty amounts to one per cent of the contractual value of the respective property (it applies to both property and land acquisition transactions). This tax remains unchanged in the Tax Code.

Land payment (land tax)

Land payment shall be made in the form of (i) land tax and (ii) land rent. The owners of the land are subject to the land tax and the lessees of the land are subject to the land rent.

It is worth noting that the essence and system of land taxation rules have not been noticeably changed by the Tax Code but the rates have been significantly changed.

Land tax

According to many experts, the Ukranian land tax is a very notional amount compared with foreign analogues. The exception is, perhaps, the calculation of the land tax at five per cent per annum of the price paid for the land in the secondary market. This regulation was cancelled in the Tax Code.

Taking the above into account it should be noted that authors of the Tax Code have increased on average by three times the tax rate for lands in populated areas with no statutory pecuniary appraisal.

As a general rule the annual land tax rate is defined as a percentage of a statutory pecuniary appraisal of land plots in a particular region.

Under the general rule, the land tax rate for land with statutory pecuniary appraisal amounts to one per cent of the value, taking into account the exceptions set out in the Tax Code for a range of land plots.

As for land in populated areas and land for industry, transport, communications and energy, the statutory pecuniary appraisal is the tax base and the tax rate amounts to five per cent, irrespective of the land purchase price specified in the sale/purchase agreement, as was the case under the old legislation.

An important innovation is the introduction of significant tax benefits for land plots allocated for development and for operating renewable energy facilities. The respective tax rate makes only 25 per cent of the tax rate applicable to the appropriate land plot. This makes business projects much more attractive for developers.

Land rent

Land rent is usually higher than land tax and is calculated based on the land tax rates and statutory pecuniary appraisal of respective land plots.

According to the Tax Code, land rent can not be less than the land tax for agricultural land. For other categories of land it is triple the land tax.

At the same time the land rent cannot exceed three per cent of the statutory pecuniary appraisal for land plots allocated for development and operation of renewables and 12 per cent of the statutory pecuniary appraisal for land plots of other designation.

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Rethinking easements and restrictive covenants

On 8 June the Law Commission completed a comprehensive review of the law of easements, covenants and profits *à prendre* ('profits'). In its report to the Government it made a series of recommendations, which they consider would make the law relating to easements, covenants and profits fit for the needs of the 21st century and a modern registration system. Their recommendations include:

- a recommendation to make it possible for the benefit and burden of positive obligations to be enforced by and against subsequent owners;
- a recommendation simplifying and making clearer the rules relating to the acquisition of easements by prescription (or long use of land) and implication, as well as the termination of easements by abandonment;
- a recommendation giving greater flexibility to developers to establish the webs of rights and obligations that allow modern estates to function;
- facilitating the creation of easements that allow a substantial use of land by the benefiting owner (eg, rights to park a car);
- expanding the jurisdiction of the Lands Chamber of the Upper Tribunal to allow for the discharge and modification of easements and profits created post-reform.

This article will examine the proposals put forward by the Law Commission in relation to easements and restrictive covenants.

Easements

Under existing English law, an easement can be acquired in a number of ways. Easements may exist by legal grant, in the form of a deeded right, by prescription or by implication. There is no standard form of easement and over the years the common law has evolved to recognise new rights such as rights to light, rights of way, rights of parking, and rights of support.

Prescription

Easements by prescription (that is, acquisition by long and regular use) may be acquired through three different methods; common law (which requires enjoyment of the right claimed since 1189), 'lost modern grant' (requiring 20 years' use of the purported easement) and under the Prescription Act 1832. The three methods are commonly pleaded in the alternative in litigation. The evidence required to establish such prescriptive easements often involves volumes of evidence from previous residents attesting to usage of the alleged rights over the relevant 20-year period. Such litigation is often lengthy and consumes a considerable amount of court time and costs. It is not unusual to see such claims occupying multiple days of hearing time and tens of thousands of pounds in legal fees.

Upon considering the present position of prescriptive easements, the Law Commission's recommendation is that the existing methods of prescription are abolished and replaced with one statutory scheme which would recognise existing legal rights. The obvious criticism of this position is that it fails to have the flexibility of the present system which has allowed 'modern rights' to be created at common law, the most recent such right to be recognised as being capable of existing as an easement is the right to park motor vehicles.

Implication

English law also recognises that easements can be created through implication, whereby the law reads the grant of an easement into a document (such as a transfer of land) even though no grant was expressly made. It is often considered to be something akin to a legal fiction giving the court power to correct obvious legal anomalies. The law relating to implication is, as a result, complex, and can be arbitrary in its operation; all of which stem as a consequence of its common law origin. Whether an easement will be implied into a transfer might depend on whether the easement would take effect as a grant or reservation, or upon whether it is 'continuous and apparent', and suchlike, which in the opinion of the Law Commissioners does not make it a fit system for the 21st century.

In its report the Commission therefore recommends the replacement of the current methods of implication with a single statutory principle that easements will be implied where they are necessary for the reasonable use of the land at the time of the transaction (unless the parties have expressly excluded its operation). What is necessary for the reasonable use of the land is to be determined through five factors that incorporate the most useful features of the current law:

- the use of the land at the time of the grant;
- the presence on the servient land of any relevant physical features;
- any intention for the future use of the land, known to both parties at the time of the grant;
- so far as relevant, the available routes for the easement sought;
- the potential interference with the servient land or inconvenience to the servient owner.

The Commissioner's report states that the benefits of their proposed scheme will simplify the law, reduce the need for complex advice and litigation, and make the process of dealing with land less costly. Reducing the need for specialised advice and simplifying the process poses a significant risk to specialised practitioners especially those at the referral Bar. In reality a large number of potential easement claims are weeded out at an early stage by retaining the experience of learned counsel, compared to the number that reach the trial stage, there is an obvious danger that attempting to overly simplifying the law in this complex area will see more claims brought by litigants *pro se* rather than fewer.

Restrictive covenants

The present position in English law is that it is possible to attach to land an obligation not to do something on it, in such a way that that obligation extends to future owners. This is known as a restrictive covenant. Unfortunately, the law of freehold covenants suffers from serious defects.

Restrictive covenants take effect primarily as contracts, meaning that liability between the original parties persists, even when one or both of them has parted with the land to which the covenant relates. Whilst the benefit and burden of a restrictive covenant can pass to future owners upon the sale of the land to which it relates, the burden of positive covenants cannot. Owing to the nature of land registration in England and Wales, the benefit of a restrictive covenant cannot be registered, meaning that it can be difficult to establish the identity of the person (or, as commonly where land has been sold by the original covenanters, persons) entitled to sue on a covenant. This means that a property may have the burden of a restrictive covenant but the neighbours unless they are the original covenanters would not have standing to bring an action if the restrictive covenant were to be breached.

The Law Commissioners address the problems surrounding restrictive covenants by recommending the introduction of a new legal interest in land (which they refer to as a land obligation). Under their proposals the land obligation would function within the land registration system, with the benefit and burden capable of registration (in the same way that dominant and servient burdens are registered with easements) so that there would be no difficulty in identifying the benefiting parties. The original parties to the land obligation would not be liable for breaches of it occurring after they parted with the land, unlike under the present arrangement.

The new 'land obligation' would exist for the benefit of an estate in land. It could either be negative or positive; the former would restrict the burdened owner from doing something on his own land; the latter would oblige the burdened owner to do something in relation to his own land. This would streamline the existing legal process and allow the litigation to be linked directly to the land in question rather than to the original covenanters.

Allowing the land obligation can be a positive obligation and conveying solicitors would no longer have to use devices such as chains of indemnity covenants or estate rentcharges, to secure the performance of positive obligations (for example maintaining a shared fence or an obligation to make a contribution towards the cost of work on a shared driveway).

The proposed land obligations have the potential to facilitate the sharing of facilities and obligations between neighbours, focusing on the actual issue rather than potentially a long line of previous owners. The Law Commissioners accept that land obligations would not be suitable in all circumstances for example in an apartment block where management companies or commonhold tenure still have a part to play.

The proposed creation of land obligations is likely to be warmly welcomed particularly among conveyancing practices and the public at large. Land obligations would provide a simple system rather than the complicated (and costly) workaround systems which are presently used. The Commission's recommendation is that they would of course only apply to new rights and would not apply retrospectively, which would be a missed opportunity. If the Government were to adopt the recommendation it would be simpler for all parties to simply transfer all existing restrictive covenants into the legal obligations, in this one area simplicity is to be commended.

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Planning to sell and leaseback? Are you accountable?

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Sale and leaseback

The sale and leaseback transaction is now regularly utilised in the UK as a source of generating large quantities of income for immediate business use, but sale and leaseback transactions have featured in the global marketplace for many years. In the past, the sale of a company's property was not the obvious route to releasing capital for expansion or other investment in a business. However, recent reports disclose that the use of such arrangements as a source of finance has grown considerably across Europe during the last decade. Many companies hold substantial real estate among their assets and due to high costs of borrowing or a large-scale withdrawal of bank funding, releasing the capital 'tied up' in property has moved to the forefront in corporate strategy.

The sale and lease will take place simultaneously. In many cases careful strategic planning by the company has resulted in the company retaining a high level of control and effectively future-proofing the lease terms. At the time of the sale, the company is both seller and proposed tenant and therefore is usually in a position to negotiate favourable terms and is particularly in a position to provide a realistic set of covenants for the repair and ongoing maintenance of any buildings.

The perks

The funds generated by the sale do not currently appear on the company's balance sheet: the lease is classified as an 'operating lease' under the current accounting rules. In addition, the lease costs are offset, being represented on the company's profit and loss account as rent expense.

Another financial benefit is that the risk of the value of the property is transferred to the purchaser. To ensure the purchaser realises its investment, and in order to ensure business continuity for the tenant, it is often the case that the parties negotiate a long-term lease. Two examples of successful sale and leaseback transactions recently in the headlines are the sales by the HSBC group of headquarters in London and New York and the expansion by Tesco globally by sales and leaseback of a number of its properties (although the company still retains ownership of around 70% of its assets).

The pitfalls

What is not so predictable is dealing with reviews of rent: businessmen do not have a crystal ball to foresee market activity in the years ahead. Two widely-publicised cases of sale and leaseback transactions going spectacularly wrong in the UK recently are the disposal of the Woolworths portfolio and the Southern Cross care homes. In the case of Woolworths, the rising costs of borrowing and the lack of availability of bank finance during the recession years resulted in the demise of the company. All their assets had been sold and leased back, and there was no asset value left in the company to accommodate the consequences of the banking crisis (what will never be known however is whether their demise would have happened earlier but for the sale and leaseback arrangement!). In the case of Southern Cross, the rental increases agreed in the leases were fixed year-on-year. In some ways this was a sensible attempt to keep control of future costs by avoiding the unknown of an open market rent review some years hence. However, the company's downfall was due to over-reliance on escalating income from local authorities meeting escalating rental costs and not retaining cash in reserve from the property sales. The company became unable to meet financial obligations including to the landlords of the properties (although a plan has now been negotiated to reduce rental liabilities and dispose of a number of properties so that Southern Cross can keep trading, at least in the short term).

Another nail in the coffin?

It is important to follow the UK Generally Accepted Accounting Practice (UK GAAP) in the sale and leaseback contracts to ensure that, in addition to releasing the capital for the investment for the business, favourable tax consequences also apply to the leasing arrangement. For example, if the property is to be sold back to the tenant at the end of the lease, it would be regarded as a finance lease rather than an operating lease. If a lease is a finance lease, it must appear on the company's balance sheet as an asset and as a liability and it features under the profit and loss account as costs of depreciation and interest.

The current accounting standards in the UK are UK GAAP alongside the International Accounting Standards (IAS). However, new legislation is under way in terms of the Finance Bill 2011 to reflect the imminent changes proposed to the IAS. The IAS Board and the Financial Accounting Standards Boards formed a joint project in 2006 to consider lease accounting and the result is a change to how leases are accounted for on a company's balance sheet.

The driver for change is a desire to achieve a uniform approach to leases on the corporate balance sheet. Improved visibility of the company's liabilities and a need to eradicate artificial values being used when accounting for leases, are some of the reasons at the core of the decision.

Under the proposed new standards, the classification of leases as 'financial' or 'operating' will be eliminated. All leases will appear on the company's accounts the way finance leases currently do. The current proposals are being considered in the UK and the outcome of the consultation process is expected to take effect from 2013.

Impact on property of the new accounting rule

The 'off balance sheet' benefit of sale and leaseback transactions will be lost, but there are many other effects on property transactions too. In an assignment situation, a tenant's accounts are often required by a landlord for the assessment of the proposed tenant's covenant strength. In practice, the financial position of the company is unaltered, but the financial stability may not be regarded in the same way with other lease liabilities being disclosed. Another matter that may result in a change of approach is how the new accounting standards will affect the average negotiated contractual duration of leases. With accounting standards based on the longest possible period of a lease, this may alter the attraction of short leases that are likely to be renewed, as the potential for a renewal will be reflected. The rules will also mean a review of a company's total liabilities on the balance sheet. Adding leases to this may impact the company's covenant strength under a loan transaction. It could be that where there are numerous leases, accounting for these results in a breach of covenant to the funder.

Is there a future for sale and leaseback transactions?

The demise of Woolworths was significant for the UK, mostly because of its 100+ years' history in the retail market. It marked a sign of the times, not so much for the end of a business with a range of products but for its historical significance. The Southern Cross situation, which is still currently in the throes of a rescue, tells an even sorrier tale of mass sales and leaseback, bearing in mind that the 'stock' affected in that scenario is our most vulnerable members of society, the aged. In many ways, the proposed accounting changes may serve as a useful tool for companies, forcing boards to place some check and measure on how they view their operational leases and how they decide on the viability of a sale and leaseback for the company. 'Out of sight, out of mind' proved not to be a solution in these two examples.

Those following the route of sale and leaseback may tread more carefully in future. It is highly likely, however, that such transactions will continue in the marketplace in the current economic climate. They are still regarded as an efficient mechanism to release funds for core business activity leaving the possibility of bank funding for another day. The level of success of the sale and leaseback arrangement across Europe, the US and, indeed globally, is likely to outshine the drawbacks. If the new accounting rules limit their effectiveness, it is still the case that the proposed increase in transparency of a company's activities in the leasing market must be considered a good thing. Providing a more accurate analysis of a company's assets where valued for investor purposes, and potentially leading to a cautious strategic approach by companies as regards the management of its assets, might mean financial stability returns to the property market for the long-term investor.

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