The Real Estate Law Review

Third Edition

Editor
David Waterfield

Law Business Research

The Real Estate Law Review

This article was first published in The Real Estate Law Review, 3rd edition
(published in March 2014 – editor David Waterfield).

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Third Edition

Editor
David Waterfield

Law Business Research Ltd

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THE PRIVATE COMPETITION ENFORCEMENT REVIEW

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Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK

www.TheLawReviews.co.uk

ISBN 978-1-907606-95-3

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

ADVOKATFIRMAN VINGE KB

AIDAR SBZ ADVOGADOS

BALCIOĞLU SELÇUK AKMAN KEKI

BONELLI EREDE PAPPALARDO

BUN & ASSOCIATES

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DE BRAUW BLACKSTONE WESTBROEK NV

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MASON HAYES & CURRAN

MORAIS LEITÃO, GALVÃO TELES, SOARES DA SILVA & ASSOCIADOS

NAGY ÉS TRÓCSÁNYI ÜGYVÉDI IRODA

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PAPADOPOULOS, LYCOURGOS & CO LLC

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SHIN & KIM

SLAUGHTER AND MAY

URÍA MENÉNDEZ

ZÁRECKÝ ZEMAN ĎURIŠOVÁ LAW OFFICE

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EDITOR'S PREFACE

Building on the success of the previous editions of *The Real Estate Law Review*, the third edition now extends to some 40 jurisdictions, and we are delighted to welcome new contributors from key countries around the world. *The Real Estate Law Review* seeks to enable practitioners and clients to meet the challenge of keeping abreast of the rapidly evolving global real estate market. Each chapter offers an up-to-date and accessible summary of the key legal and practical developments in the relevant jurisdiction, and a vital snapshot of the important market drivers, trends and opportunities. Together, the chapters provide an invaluable overview of international real estate.

It is no longer possible to look at domestic markets in isolation; real estate has become a global industry, and *The Real Estate Law Review* reflects that status. An awareness of the global real estate market and an understanding of the practices and requirements of overseas investors are vital if practitioners and their clients are to take advantage of investment trends and opportunities as they develop.

The Real Estate Law Review continues to provide an overview of the state of the international real estate market, including the types of investor, the sources of funding and those assets that are in demand. In general, the focus remains on prime properties in the world's leading global cities as investors continue to seek a safe haven for their capital. Although this remains the case with London, investors are starting to see opportunities in the wider UK market, and we are generally more optimistic than at this time last year. However, positive recent news, data and forecasts must still be considered in the light of continuing economic and political challenges, including the next US fiscal cliff, uncertainty in emerging markets and the stability of the eurozone.

Once again, I wish to express my gratitude to the distinguished practitioners from across the globe who have provided invaluable contributions to this edition. As ever, I would also like to thank Gideon Roberton and his team for their sterling efforts in compiling this third edition of *The Real Estate Law Review*.

David Waterfield
Slaughter and May
London
February 2014

Chapter 1

AUSTRIA

Peter Madl[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

The principal laws governing real estate in Austria are:

a the General Civil Code 1811;[2]
b the Building Right Act 1912;[3]
c the Condominium Act 2002;[4]
d the Building Development Contract Act 1997;[5]
e the Tenancy Act 1981;[6]
f the Land Register Act 1955;[7]
g the laws governing the acquisition by foreigners of land of the nine federal states;
h the Real Estate Investment Fund Act 2003;[8] and
i the building laws of the nine federal states.

Ownership of land and ownership of a building erected thereon are usually not separated; there are, however, two exceptions. The Building Right Act permits the landowner to give title to any buildings erected on the land (whether already existing or erected in the future) to another person for a period of between 10 and 100 years. At the end of

1 Peter Madl is a partner at Schönherr Attorneys at Law.
2 As amended by the Federal Law Gazette 2013/179.
3 As amended by the Federal Law Gazette 2012/30.
4 As amended by the Federal Law Gazette 2012/30.
5 As amended by the Federal Law Gazette 2013/159.
6 As amended by the Federal Law Gazette 2013/50.
7 As amended by the Federal Law Gazette 2012/30.
8 As amended by the Federal Law Gazette 2013/184.

the agreed period, the title to the buildings reverts back to the landowner. The second exception is that, before a building is erected, the landowner may agree with the tenant that this building will be built by the tenant on a temporary basis and thus does not become part of the land (*superficies*). As opposed to the building right, the *superficies* is not entered in the land register, and therefore is not as secure; nor does it serve as security for financing as easily.

ii System of registration

The land register covers the real estate of a particular district and is kept by the district court of the district in which the property is situated. It is maintained in an electronic database that has limited public access (i.e., to notaries public, lawyers and other entities that have a legal interest, e.g., banks). Excerpts can be obtained from any district court, or in electronic form from other institutions having access to the database. Since 2005, not only the land register excerpt itself, but also the underlying documents (e.g., the purchase contract), are available electronically. It is not possible to protect from disclosure confidential information that is contained in documents that are the basis for the entry in the land register; however, it is permissible to conclude side letters that are not submitted to the land register.

The land register consists of the general ledger and archives. The general ledger contains a land register enclosure for each existing surface area, which also includes the estate's lot number.

The individual enclosure contains three parts (folios):

a details of the property: the A folio covers two departments. In the first department (the A1 folio), properties are registered with their respective lot number and disposition of use, size and address; the second department (the A2 folio) contains the rights and public restrictions connected with the real estate (e.g., easements on the entitled property, write-offs, public restrictions and burdens);

b ownership: the B folio contains details about the proprietorship structures; and

c encumbrances (mortgages, easements): the C folio shows encumbrances on the real estate, in particular mortgages, easements, real burdens, prohibitions of sale or encumbrance.

Under Austrian law any grant, transfer or limitation of rights pertaining to real property generally must be registered in the relevant land register to bind third parties. Therefore, a proprietorship in real estate may only be transferred on the basis of a legal title (e.g., a purchase contract) by registration in the land register. Unless a legal transaction involving real estate is registered, the party to the contract has only a contractual claim for performance against the other contracting party.

In a very limited number of exceptions to this principle, title passes without an entry in the land register: this is the case with adverse possession, inheritance, mergers and demergers (universal succession). However, even in these rare exceptions, the right is lost again if a third party acquires the title in good faith from the registered owner.

Applications to the land register must be submitted electronically by persons with access (especially solicitors and notaries public). This change, from submitting applications to the land register by post, has reduced the time needed for registrations and publication of the documents that are the basis for the entry.

iii Choice of law

The parties are free to choose the law governing the contract and the court that will have jurisdiction over any disputes relating to the contract. Austrian law is, however, mandatory regarding rights *in rem* to real estate located in Austria. Further, any disputes concerning such rights *in rem* mandatorily fall within the jurisdiction of the Austrian courts. International laws are, therefore, not relevant to real estate in Austria; however, international treaties and conventions regarding real estate are applicable.

II OVERVIEW OF REAL ESTATE ACTIVITY

Certain market participants had restructuring phases because of changed circumstances in Europe after the crisis from 2008 to 2011. However, even during the crisis, the Austrian market remained comparatively stable; the transaction volume decreased, but the prices did not decrease as much as in other countries. Although the majority of the transactions still took place between domestic parties, especially private foundations and family offices invested in apartment and office buildings in prime locations, some German funds, which used to be major investors, made a return as buyers. Even those German funds that have to sell their assets as the funds are now closed have come back with other funds as buyers; however, for these funds the prices are still rather high, and it is difficult to establish deals for them. In 2013, banks and insurance companies sold off buildings in prime locations at rather low yields, which attracted interest from buyers wanting to have landmark buildings in their portfolio.

Investment in the property market was weak in the first three quarters of 2013, but was expected to rise in the fourth quarter, and the total transaction volume for the year is expected to be approximately €1.6 billion, missing the level of 2012 by €0.2 billion or 11 per cent.[9]

The volume of investment related to office buildings decreased compared with 2012, while there was a remarkable increase in investments in residential buildings. Investments in hotels, retail properties and logistics remained stable.

The prime initial yield for newly built office properties with long-term leases in very good locations (outside the city centre) amounted to 4.8 per cent at the end of 2013; this has decreased further since 2012. Yields in good locations decreased slightly and remained steady in average locations. The difference in yields in distinct locations (e.g., very good locations, good locations, average locations) became larger again in 2013, and this gap will continue to widen.

After coming under considerable pressure in 2011, the rental market remained stable in 2012 and 2013. Rents did not increase, except in top locations, where the highest achievable rent increased slightly. However, tenants were able to negotiate more incentives, such as rent-free periods (approximately one month per year of a fixed lease

9 Source: CBRE.

period for the tenant) and contributions to fit-out works, just to keep the nominal rental figure up at the same level. The vacancy rate increased slightly from 6.6 per cent at the end of 2012, and is expected to be close to 7 per cent by the end of 2013. 2013 saw the lowest number of finished projects for many years, and the beginning of a tendency for older office buildings to be converted into apartment houses, especially in the centre of the city. This may lead to a change, with the market becoming a landlord's rather than a tenant's market.

III FOREIGN INVESTMENT

The acquisition of real estate by foreign nationals is governed by federal state laws. This is also true for the acquisition of certain rights such as usufruct, building rights or long-term leases, depending on the respective state.

In almost every federal state in Austria, foreign nationals must obtain prior approval from the land transfer authority to purchase land. This also applies to companies where a foreign national is a majority shareholder.

Under some land transfer acts, the acquisition of shares or the increase of shareholdings in an Austrian limited liability company or partnership is subject to the prior approval of the land transfer authority if this company or partnership owns real estate located in the relevant states.

Under all land transfer acts, EEA or EU citizens and companies are treated in the same way as Austrian citizens or companies. Swiss natural persons who have their permanent residence in Austria are also treated like Austrian citizens (although this does not apply to Swiss-based companies).

The foreign national must prove an economic, social or political interest with regard to the Austrian state in which he or she wishes to acquire land or the respective right. The most usual reason given is economic interest: the foreign national wishes to invest to create new jobs in Austria.

All federal state laws (with the exception of those of Vienna) provide restrictions on the acquisition of agricultural land and forest areas. Agricultural land is most commonly defined as a plot suitable for agricultural use. Acquisition of title on these properties depends on the approval of the competent land transfer authority irrespective of the nationality of the buyer and, therefore, in addition to the approval needed by foreign nationals. A formal application must be filed with the competent land transfer authority. The land transfer authority will approve the acquisition of agricultural land if it complies with the requirements of the respective federal state law; in most cases, other farmers in the region have priority rights, and the buyer must prove his or her ability to run an agricultural business.

IV STRUCTURING THE INVESTMENT

Commercial real estate projects are structured either as a straightforward asset deal or as a share deal with special purpose vehicles (SPVs). Even in asset deals, however, the buyer is often structured as an SPV to have both exit options.

The asset deal triggers land transfer tax of 3.5 per cent and a fee for registration in the land register of 1.1 per cent of the consideration (including possible value added tax (VAT)). On the other hand, the basis for depreciation is the actual purchase price and therefore higher than in the case of a share deal, and interest for financing is easily deductible at the level of the owner of the land. The asset deal also avoids the risk of latent taxes if at a later stage an exit via an asset deal is contemplated. The share deal avoids any risks to the buyer in respect of the transfer of contracts, especially lease contracts, but has a higher risk in respect of liabilities within the SPV.

Depending on the holding or ownership structure of such SPVs, the most common structures seen in the Austrian market are a limited liability company and a limited partnership.

The suitability of particular structures for real estate investment will largely depend on their tax attractiveness for the intended investors, as well as on the costs and ease of operating the holding structure. The regulatory limits on the types and origin of investments that bind some domestic institutional investors, in particular pension funds, may also bear on the structuring of the investment.

i Limited liability company

Limited liability companies are attractive and easy-to-operate investment structures, especially popular with foreign funds and other investors who are not bound by any special regulatory restrictions determining the desired form of investment. An Austrian limited liability company will be taxed with corporate income tax at a rate of 25 per cent; however, the overall tax burden will largely depend on the holding structure.[10] Moreover, limited liability companies may not be the most attractive or effective structures for some types of investors.

In its basic form, a limited liability company needs to have a management board consisting of at least one management board member.

It is possible for one investor to hold all the shares in a limited liability company; however, the acquisition of 100 per cent of the shares (in one step or in several steps) does trigger land transfer tax at a rate of 3.5 per cent of three times the standard value of the property, and is therefore to be avoided.[11]

ii Limited partnerships

A limited partnership established under Austrian law is not a legal entity, but it may acquire property, including real estate, in its own name. A limited partnership must have at least one general partner who is liable for the debts of the partnership without any limitation, and at least one limited partner. It is common that a limited liability company becomes a general partner in a limited partnership and is not entitled to the

10 Upon distribution of profits, a withholding tax from 25 per cent of the profit distributed becomes due, which leads to an overall tax burden of 43.75 per cent; depending on the holding structure, this withholding tax can be reduced to zero.

11 The standard value is an assessed value for tax purposes calculated in accordance with the Valuation Law, which is normally considerably lower than the market value.

profit, but receives only a fixed fee for the management tasks and for assuming the risk as the personally liable partner.

From a corporate income tax perspective, the limited partnership is transparent (i.e., no taxation at partnership level, and tax paid only at shareholder level).

Despite the relatively complicated structure and higher costs, the above investment scheme is very attractive for investors. The costs of the structure are outweighed by the tax benefits, especially in the case of larger investments, and the availability of the scheme to institutions makes it an interesting option for structuring real estate investments.

V REAL ESTATE OWNERSHIP

i Planning

Building, regional planning and zoning regulations are subject to state legislation. The laws of each federal state vary in detail but follow the same basic principles.

The building laws set out basic material and procedural rules for regional development and building constructions. Each municipality enacts a zoning plan and building regulations based on these rules, to govern the development of and set maximum limits for construction in certain areas (such as recreation and industrial areas).

Prior to the construction of a new building, it is necessary to obtain a building permit. The building laws list exhaustively the cases in which a building permit must be obtained. Construction work may not be carried out before the permit has been granted and has become effective and final. Furthermore, a building permit is appurtenant to the property. Therefore, the building permit remains effective for the successive owner of a property, even if it was granted to his or her predecessor. The building permit grants the right to carry out the building project underlying the application, and expires after a certain term, during which the construction has to start, which depends on the applicable regional building law (e.g., a building permit in Vienna is valid for four years according to the Viennese Building Act).

ii Environment

According to the Clean-up of Contaminated Sites Act, a list of suspected contaminated properties has been compiled and is publicly available on the website of the Environment Agency Austria.[12] If a property appears to present a significant environmental threat, it is scheduled in a list of properties that require clean-up measures. Once listed, the competent authority must determine whether anyone can be held liable for the repair of the damage or the payment for the decontamination. Usually the party that caused the contamination is primarily responsible; however, in special cases the owner of the land who has consented to a certain use of the property and received remuneration for this use can also be held liable by the authority. If nobody can be held liable, the federal government must carry out the necessary actions under the Clean-up of Contaminated Sites Act. If a property is not listed in the schedule, this does not necessarily prove that the property is not contaminated.

12 www.umweltbundesamt.at.

iii Tax

Sale proceeds on real estate within the meaning of the VAT Act 1994[13] are exempt from VAT. Businesses can, however, treat transactions concerning real estate as taxable (opting in). If so, the VAT paid in (at 20 per cent) is deductible for business purchasers, but VAT is also subject to the land transfer tax and the registration fee. It is sensible for a seller to opt in if he or she has invested in the real estate in the past 20 years and has claimed input VAT for these investments, because the input VAT must be returned *pro rata* to the tax authority if the sale is not subject to VAT.

Land transfer tax must be paid on the acquisition of real estate at a rate of 3.5 per cent of the purchase price including VAT (or 2 per cent if purchased by a spouse, first-degree ancestor or first or second-degree descendant). The parties involved in the acquisition are liable as joint and several debtors. Therefore, it is advisable for the purchase agreement to set out which party must pay the tax (usually the buyer).

A registration fee of 1.1 per cent of the purchase price including VAT must be paid by the party who applies to register the transfer of ownership at the time of registration.

With regard to share deals, it is common (especially on acquisitions of large real estate portfolios) to avoid the land transfer tax by acquiring shares in the company holding the real estate through two different companies in different VAT groups (e.g., one buyer and an affiliated company holding a minimum share); however, if these two companies merge, then the land transfer tax becomes due.

iv Finance and security

Basically, two types of mortgages are common in loan agreements: the conventional fixed-amount mortgage and the maximum-amount mortgage.

A fixed-amount mortgage is a pledge of real estate, and is created by a written and notarised mortgage agreement (including possible ancillary claims for costs, interest, etc.) that must be registered in the land register. In addition, this agreement must contain the mortgagee's explicit declaration of agreement to the registration of the mortgage on a certain parcel of land to allow the unconditional registration of the mortgage with the C folio of the land register.

Moreover, under Section 14 of the Land Register Act, the registration of a mortgage is possible for an amount of money up to a certain ceiling (including the interest in the case of an interest-bearing claim). The fixed amount depends on the underlying receivable plus a surcharge, which is fixed by the parties at approximately 20 per cent to 30 per cent of the receivable. These mortgages provide security for any existing claims or those arising in the future from a specific business relationship.

The maximum-amount mortgage is also accessory to the underlying legal relationship but not to a particular claim. Therefore, it is not possible to detect if a claim is subject to the maximum-amount mortgage only by a search in the land register. After repayment of the loan, no more claims can arise, but the maximum-amount mortgage remains valid until the existing legal relationship is liquidated. If the outstanding claims exceed the maximum amount, the pledgor owning the real estate has to pay only the

13 As amended by the Federal Law Gazette 2013/63.

outstanding claims to the limit of the maximum amount to cause the extinction of the mortgage, whereas the debtor has to pay the whole debt.

A registration fee of 1.2 per cent of the secured amount must be paid by the party that applies to register a mortgage.

VI LEASES OF BUSINESS PREMISES

Austrian laws regarding leases are highly restrictive. Lease agreements for residential and business purposes are primarily governed by the Tenancy Act, which aims mainly to protect tenants' interests. The provisions of the Tenancy Act, with a few exceptions, cannot be waived or otherwise modified to the disadvantage of the tenant. The Tenancy Act does not apply to real estate leased in the tourist industry, parking garages, warehouses, employee housing, business premises leases for a definite period not exceeding six months, apartments used for recreation, the lease of flat land without buildings, or houses with only one or two separately leasable objects. If the premises are part of a building newly established without public funds based on a building permit issued after 30 June 1953, only parts of the Tenancy Act will be applicable, such as the provisions on the termination of contracts, whereas the other provisions – especially those on rent control and the limitation on operating costs that can be charged to the tenant – do not apply.

In general, lease contracts that fall under the Tenancy Act (fully or in part) and were entered into for an indefinite period may only be terminated by the landlord for the specific grounds listed in the Tenancy Act (rent protection). As opposed to the laws in many other countries, rent protection also applies to the lease of business premises.

The landlord may only terminate a lease agreement for good cause, such as the tenant's default of payment despite reminder or a substantially detrimental use of the premises by the tenant. Other reasons for termination may only be validly agreed if they are comparable with those provided for by law; otherwise they are void and unenforceable. In contrast, the tenant may terminate the agreement at any time without cause.

Lease contracts on business and residential premises are frequently entered into for a definite term (at least three years are required in the case of residential premises) to avoid the application of termination provisions that clearly favour the tenant. For business premises, there is no limitation on the definite term; however, five years is the minimum in the market, and 10 to 15 years is not unusual.

A written lease agreement is subject to stamp duty at a rate of 1 per cent of all rental payments (including service charges, operating costs and VAT). For indefinite contracts, the stamp duty payable is calculated on the basis of three annual rental payments. For fixed-term contracts, the stamp duty is calculated on the basis of the rental payments for the whole term, up to a maximum of 18 years (or three years for apartments).

Generally, the parties are free to agree upon the amount of rent payable for commercial premises provided that, from the day the lease agreement is executed, the rent is adequate for the relevant category (type, condition, location and maintenance) and size of the property (if the Tenancy Act is fully applicable). Apartments may be subject to a complex system of rent control. Typically, it is agreed in the contract that rent is adjusted from time to time (indexed), usually according to the consumer price index, with the index change taken into consideration in the full amount every year (sometimes a threshold of 3 per cent to 5 per cent is agreed); however, it is also permissible to agree to a rent review clause to keep the rent in line with the market.

Change of control of a company does not affect its holdings of real estate. The tenant of business premises, however, must notify the landlord of any substantial changes in its ownership structure or if the tenant sells the enterprise conducted in the premises, if the Tenancy Act is fully applicable. Such sale of the enterprise does not amount to good cause for the landlord to terminate the lease, but the lease contract passes over to the buyer and the landlord can (if the Tenancy Act is fully applicable) increase the rent to market level. The right to increase the rent also applies to corporations as tenants upon a substantial change in (economic and legal) control over the tenant, such as where a merger or a change in the tenant's shareholder structure occurs.

A tenant might be granted the right to sublet. If the tenant sublets the whole object of the lease or asks an unreasonable sublease rent (more than 50 per cent above its own rent and investment) without consent, the landlord can terminate the main lease (as a result, the sublease is also cancelled, but the subtenant may request damages from his or her sublessor).

Usually, the landlord takes out adequate insurance for the building, continuously maintains in force such insurance and provides proof thereof upon request, to ensure insurance cover in respect of the following risks: building liability insurance, including a duty to ensure safety for persons and vehicles; and building insurance (e.g., fire, lightning or explosion, flooding, sewage, storm, hail, malicious damage, overvoltage, costs of clean-up, salvage and security). Insurance costs are part of the operating costs that are charged to the tenant.

A landlord must keep the leased premises in good condition, unless otherwise agreed.[14] It is common to exclude the landlord's maintenance obligation, except in relation to structural repairs (see Section VII.iii, *infra*). A tenant cannot waive his or her right to reduce rent payments in advance, to allow for potential inability to use the premises.[15]

VII DEVELOPMENTS IN PRACTICE

i Land transfer tax in share deals

With regard to share deals it is common (especially on acquisitions of large real estate portfolios) to avoid the land transfer tax and registration fee by acquiring shares in the company holding the real estate through two different companies (e.g., one buyer and an affiliated company holding a minimum share). It was commonly held that the only requirement was that the two companies were not in the same VAT group (or would not be in the same VAT group if they resided in Austria), thus the second shareholder held a minimum share and acted as trustee for the main shareholder.

However, this well-established practice was questioned in a decision in 2010 by the Independent Finance Tribunal of Innsbruck, which argued that, in special cases, the

14 Section 1096 of the Civil Code.

15 Ibid.

formal existence of two shareholders does not stop the finance authorities assessing the economic background and deciding that tax may be triggered on the basis of all shares being, in fact, unified; this decision was upheld by the Higher Administrative Court in 2011. Although the decision says that this view is limited to very special circumstances (which were given in the case at hand), it remains unclear as to when exactly such special circumstances occur.

Therefore, it is advisable not to have the minority shareholder as trustee for the main shareholder, but to grant the minority shareholder rights of its own, including a profit share.

ii No termination right of landlord in case of insolvency of tenant

Since 1 July 2010, in the first six months after the opening of insolvency proceedings, a landlord is only entitled to terminate a lease contract that is important for the continuation of the business of the tenant for good reasons (unless the termination is necessary to avoid serious personal or economic disadvantages for the landlord); however, the deterioration of the economic situation of the tenant and the non-payment of rents due before opening of insolvency proceedings may not be used as good reason.

Therefore, landlords must decide to terminate a lease contract for non-payment at an earlier stage than they would have done prior to this change.

iii Maintenance costs – Supreme Court ruling

On 11 October 2006, the Supreme Court decided that consumers do not have to bear maintenance costs for lease objects as they had done in past decades under standard clauses in lease contracts.

If the Tenancy Act is fully applicable (this is mainly for buildings built before the Second World War), Section 3 of the Tenancy Act stipulates which maintenance costs must be borne by the landlord, while Section 8 stipulates which maintenance costs must be borne by the tenant. A broad area of other maintenance work, however, is governed neither by Section 3 nor Section 8 (usually referred to as the 'grey area' of maintenance obligations). This is quite important in practical terms, as it includes maintenance of heating systems, boilers and dishwashers. The grey area is governed by Section 1096 of the Civil Code, whereby the landlord must hand over the lease object to the tenant in a proper condition and maintain it as such. For decades, in almost all lease agreements, the landlord insisted that these maintenance obligations be borne by the tenant. The Supreme Court ruled that this practice violated the Consumer Protection Act and is not permissible.

The Supreme Court has pointed out that, for lease agreements to which the Tenancy Act is fully applicable, the landlord need not (initially) maintain parts of the building that are not explicitly mentioned in Section 3 of the Tenancy Act. Interestingly, however, this does not imply that the tenant must bear all maintenance costs (along with those stipulated in Section 8); according to the Supreme Court, neither the landlord nor the tenant initially has to bear maintenance costs in this area. This solution, however, is a double-edged sword from the landlord's point of view: if the lease object becomes unusable, the tenant may decrease the rent payments and, therefore, the landlord has to decide whether to tolerate decreasing rent payments or to undertake the maintenance work at his or her cost.

A consequence of the judgment is that, for lease agreements to which the Consumer Protection Act applies (cases where the landlord is a businessperson and the tenant a consumer), the tenant's maintenance obligations may not be contractually agreed at all. For lease agreements where the Tenancy Act is only partly applicable, Sections 3 and 8 of the Tenancy Act will not apply; in such cases, the tenant need not even pay costs for maintenance covered by Section 8 of the Tenancy Act.

This regime is the complete opposite of what had been the Austrian standard practice for lease agreements, and some professional landlords have yet to grasp fully the economic impact of the Supreme Court's decision in this respect. Landlords will eventually have to increase the rent they are asking for private housing. In fact, the product they are offering has substantially changed: landlords must now offer the maintenance of this object and of all the installations that have been rented to the tenant along with the lease object.

VIII OUTLOOK AND CONCLUSIONS

The outlook for the real estate sector in 2014 still depends largely on the availability of financing for transactions and development of new projects. Banks are still cautious about financing developments, but other means of financing, such as bonds issued by the developer and secured in the land register, are being used to compensate for this. Tenants are primarily moving to offices that offer better quality and are less spacious; there is not much demand for additional space. Due to the insecure economic environment, the outlook for new developments remains – although slightly recovering – poor.

The outcome of 2013 – that the market further consolidated the recovery from the earlier slowdown and that some interesting transactions took place – allows for cautious optimism. On the other hand, the general investment climate in Europe, and questions relating to the economy of the region as a whole, are also causing some uncertainty in the Austrian market.

Chapter 2

BELGIUM

Yves Delacroix[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

Under Belgian law, two types of rights over real estate exist. The first are rights *in rem* relating to a certain direct control over real property:

a full ownership right, which is the most absolute right over an object and includes the rights of use, enjoyment and alienation (sale, granting other rights, destruction) within the limits of mandatory law, and which is unlimited in time;

b easement, which allows one property to be burdened to facilitate the use of another property;

c usufruct, which is a right to use a property owned by someone else, and to benefit from its profits or products, under the obligation of preserving its substance; a usufruct may last no longer than the life of the usufructuary and a maximum of 30 years if the beneficiary is a legal entity;

d *emphyteusis*, which is a special kind of long-term lease giving the right to use and build on real estate in return for the payment of an annual ground rent; a long lease is granted for a minimum of 27 years and a maximum of 99 years; and

e building right, which is a right to have ownership of buildings or structures on someone else's land; a building right is granted for a maximum of 50 years.

The second are rights *in personam*: claims allowing the request of a certain performance from another party (leases).

Apart from these, there are a number of accessory real rights such as mortgages and pledges. Ownership can also take the form of commonhold (condominium ownership).

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The list of real rights is fixed by statute; it is not possible to create additional real rights by, say, contract. This is known as the *numerus clausus* principle.

ii System of registration

Ownership and property is evidenced in the Mortgage Register, in which all transfers of property – rights *in rem*, including mortgage deeds and easements (with the exception of the legal easements), as well as leasehold interest of a duration of more than nine years, must be described to be effective against third parties.

Land and buildings are also described in the Land Register, which also has other purposes (the Land Register sets out the categories to which each land parcel or building belongs and indicates the related estimated annual income, which is used for the calculation of the real estate withholding tax).

There is no state guarantee as such, and the Mortgage Register cannot be held liable for the registration of inaccurate information provided, it being understood that the Mortgage Register may only be held liable if the provided information is inaccurately processed.

Belgian notaries may be held liable for the validity and binding force of the deeds passed before them.

iii Choice of law

Belgian property law is essentially contained in the Belgian Civil Code, which contains the rules applicable to sales, leases, construction, etc. The Code also contains specific rules dealing with, *inter alia*, retail leases, residential leases and farm leases. Specific legislation exists for long leases, surface rights and mortgages.

Interpretation of the Civil Code by the courts – especially the Supreme Court – plays an important role.

Planning and environmental regulations are governed by Flemish, Walloon or Brussels regional legislation. Investors must obtain the necessary permits and permissions for each real estate project they set up in Belgium to ensure that they comply with these planning and environmental regulations.

II OVERVIEW OF REAL ESTATE ACTIVITY

The eurozone sovereign debt crisis has been a big threat to the Belgian real estate market in 2012. The impact on the economy has affected the demand for offices or logistic premises, as well as consumption in retail stores. The sovereign crisis has affected both investors and tenants with, for instance, sustained economic pressure on eurozone governments to keep expenditure, such as occupancy costs, under control; this has affected the Belgian real estate market, as the Belgian state and the European Union are two of the major occupiers of office premises in Brussels (Belgium's most important market). Investors became increasingly cautious and risk-averse, and the banks themselves also became extremely cautious in financing real estate transactions.

During 2013, the economic sentiment has, however, improved; the Belgian economy was no longer in recession at the end of 2013 with a 0.2 per cent GDP growth rate. According to a report drafted by DTZ, the total real estate investments for 2013 are expected to be above €2 billion for the first time since the crisis. According to DTZ, economic recovery is likely to start in 2014, and to accelerate from 2015.

It seems that offices are quickly coming back into favour for investors (the office segment in 2013 will represent 65 per cent of all investment, against 50 per cent in 2012). For the first time since the economic crisis, it appears that investors are willing to invest in offices again, although deals have become increasingly difficult and often take more time to complete. If the economic recovery continues, more transactions are certainly to be expected in 2014.

III FOREIGN INVESTMENT

Although tax consequences may be different for non-Belgian ownership, there are generally no restrictions on ownership or occupation by foreign entities. Neither are there any restrictions in principle on obtaining loans from either Belgian or foreign banks, it being understood that the source country of finance is important from a tax point of view (since the tax treaty, if any, may determine to what extent withholding tax is charged on interest payments).

As regards security rights, no restrictions exist except for the general pledge over the business (similar to the floating charge in the UK), which can only be in favour of an EU-licensed credit institution.

IV STRUCTURING THE INVESTMENT

A very common structure by which to invest in real property is a direct purchase (asset deal). Many transactions, however, especially large transactions, are done through company acquisition (share deal) because of tax considerations. Split sale was another commonly used structure in real estate transactions prior to the introduction of the anti-abuse tax provision introduced in Belgium by the law of 29 March 2012. A split-sale structure (see Section VII.iv, *infra*) was generally used for tax reasons and is no longer permitted under the terms of the new provision.

i Share deal (sale of shares of a company owning real estate)

A share deal (sale of shares of a company owning real estate) remains a common way to structure the investment. Transfer taxes (see Section V.iii, *infra*) are, in principle, not due in the case of a share deal. As a rule, except in cases of simulation (for instance, if the property is contributed to a new company after agreement has been reached on the object of the sale and the shares of the company are sold instead of the asset) no registration tax is due on the sale of shares. Even if the sole asset of the company is the real estate, in principle, no registration tax is due. Since, in practice, the transfer tax due in the case of an asset deal is usually borne by the purchaser, a share deal may produce a substantial saving on transfer tax for the purchaser.

From a direct tax viewpoint, in the case of a share deal, since the property does not change hands, the transferred company continues to depreciate the real estate during the remaining depreciation period and on the remaining depreciation basis. When the company later sells the real estate, a taxable capital gain is usually realised. The capital gain is equal to the difference between the sale price and the tax value of the real estate in the company's books, meaning the historical cost less depreciation (the sale price is usually higher than the tax value of the real estate in the books); hence, at the time of the sale of the shares, the valuation of the shares should take into account the tax latency (i.e., the present value of the future potential tax burden in connection with the sale of the real estate by the company). The calculation of the tax latency should also take into account that the share price or goodwill cannot be depreciated under Belgian tax law. The burden of said tax latency is usually shared between seller and buyer.

Corporate income tax is levied in Belgium at a rate of 33.99 per cent. The tax on capital gains on fixed assets held for at least five years can be deferred subject to reinvestment of the full proceeds of the sale price in depreciable assets. The tax is then recaptured over the duration of the new depreciation.

Tax losses can be carried forward indefinitely; however, in the case of a change of control not justified by legitimate financial or economic needs, tax losses are barred. An advance ruling can be applied for with respect to the existence of legitimate financial or economic needs. The ruling commission, however, often considers that a change of control of a real estate company is not justified by legitimate financial or economic needs; hence, carried-forward tax losses are generally not taken into account for the calculation of the sale price of the shares.

V REAL ESTATE OWNERSHIP

i Planning

Each region has enacted its own town and country planning code. In the Flemish region, the Flemish Code of Planning and Zoning applies. This Code is a compilation and coordination of the Flemish Regional Acts of 22 October 1996 on planning and zoning and of 18 May 1999 on the organisation of planning and zoning. In the Walloon region, the Walloon Code of planning and zoning, urban development, heritage and energy applies. In the Brussels metropolitan region, the Brussels Code of planning and zoning applies.

In all three regions, every property falls within a particular zoning area, determined by the applicable zoning plans (the regional zoning plans and the municipal zoning plans). These plans must be taken into account whenever the competent authorities must deal with any application for a building permit, but also when delivering any other permit, such as environmental permits or the extension or renewal of any environmental permit.

Carrying out construction works also requires a building permit. Erecting a building without having previously obtained such building permit is a criminal offence, as is the maintaining of buildings erected without a permit. In the Walloon and Brussels regions, the building and environmental aspects are addressed in one single permit. This is as yet not the case in the Flemish region, where both permits must be obtained separately. This time-consuming requirement in the Flemish region is, however, due to be removed. On 19 April 2013, a draft of a new Flemish Regional Act was approved, providing that the building and environmental aspects shall be addressed in one single permit. The entry into force of this Act is expected during 2015.

Non-compliance with the applicable provisions of the zoning plan or building permit can trigger a variety of administrative, civil and criminal sanctions.

ii Environment

All three regions have adopted a comprehensive set of rules relating to soil and groundwater contamination. The three regional schemes on soil contamination present similarities but also notable differences. The following common principles can be mentioned for the three regions:

a Various events (e.g., accidental pollution or fortuitous discovery of pollution, the transfer of land where risk activities – activities considered as potentially causing soil pollution – were carried out, starting and ending a risk activity, etc.) will trigger the obligation to conduct a preliminary soil survey, performed by a licensed soil expert. Said preliminary soil survey must be filed with and approved by the regional public waste agency.

b The regional public waste agency can request that it file a descriptive soil survey if there are indications that the soil clean-up thresholds have been exceeded, or that the pollution is a serious threat for the environment and human health. The filing of said descriptive soil survey can give rise to the drafting of a soil clean-up project and, ultimately, to the cleanup of the land. Both the descriptive soil survey and soil cleanup project will require prior approval by the regional public waste agency.

c In principle, the author of the contamination will be held liable for the pollution.

Every regional soil contamination regulation provides for exonerations of the aforementioned obligations. Breaches of said regulations can also give rise to criminal sanctions.

iii Tax

Under Belgian law, the sale of real estate is subject to a registration tax of 12.5 per cent (if the property is located in the Walloon or Brussels region) or 10 per cent (if the property is located in the Flemish region). The registration tax is calculated on the purchase price, which may include the charges imposed on the purchaser. If the fair market value is higher than the purchase price, however, the registration tax is calculated on the fair market value. Seller and purchaser are jointly liable to pay the registration tax. In practice, however, registration tax is usually borne by the purchaser.

The sale of a new building may be subject to VAT at a rate of 21 per cent, in which case no proportional registration tax is due. If the seller is a professional builder, the transfer of a new building is automatically subject to VAT. Any other seller should opt to sell a new building with VAT; this tax is due on the purchase price of the new building. As previously mentioned, pursuant to a measure that entered into force on 1 January 2011, if a new building is transferred with VAT, the tax will also be due, under certain conditions, on the transfer of the land.

Transfer tax exemptions might be available if real estate is transferred in the framework of the transfer of an undertaking or in the framework of reorganisation.

iv Finance and security

The only form of security taken in relation to immoveable property is a mortgage. A standard security package required by third-party lenders generally consists of a mortgage or a mortgage mandate.

In large transactions, the lender would also take security over other assets, such as a pledge over the receivables (rental income), a pledge over the shares of the borrower if the parent company is involved in the loan, and a pledge over shares held by the borrower in other companies, or a business pledge (similar to a floating charge in the UK).

A mortgage deed must be signed before a notary public; substantial costs can be involved in the vesting of the mortgage, mostly in connection with registration duties and inscription duties at the Mortgage Registry (the cost amounts to approximately 1.4 per cent of the mortgage amount). As a result of this, borrowers will try to have the mortgage granted for an amount less than the value of the loan, and then grant a proxy to mortgage – by which the debtor irrevocably authorises the lender to establish a mortgage on the property – in addition to the mortgage (the borrower will then only pay duties on this second mortgage if and when it is actually established). Proxies to mortgage minimise costs but increase the risks for the lender. They are fairly common in real estate transactions; when used, the lender usually takes a first-ranked mortgage for a lower amount, coupled with a proxy for a more substantial amount. Proxies to mortgage must also be executed before a notary public. A proxy to mortgage does not grant any priority rights as such; it is only once the proxy has been exercised (and the mortgage subsequently registered) that the mortgage becomes effective and binding *erga omnes*. As such, a proxy to mortgage does not prevent third parties (acting in good faith) from obtaining rights *in rem* over the property, even if the proxy to mortgage is subject to a negative covenant (negative pledge).

In addition, certain lenders take *in rem* security rights over the entire business of the debtors by way of pledges. The creditors (lender or agent) and the beneficiaries of this security must be licensed credit institutions. A business pledge must be registered at the Land Registry and an amount of 0.5 per cent of the amount for which the inscription is taken is due.

VI LEASES OF BUSINESS PREMISES

Under Belgian law, four different types of lease agreements are to be distinguished:

- *a* common lease agreements (concerning offices, parking spaces, warehouses, industrial buildings, etc.);
- *b* residential lease agreements (the lease of the tenant's principal residence);
- *c* commercial lease agreements (leases that are mainly utilised by the lessee or by a subtenant to carry out retail or craftsperson's activities in direct contact with the public); and
- *d* agricultural lease agreements.

Common lease agreements are subject to the general provisions of the Civil Code.[2] Lease agreements of the other types are governed by specific legislation in the Civil Code. Commercial lease agreements (retail and artisanal activities) are, for instance, governed by the Commercial Lease Act of 30 April 1951. The general provisions of the Civil Code apply by default to this type of lease agreement insofar as those special rules do not deviate therefrom. Most provisions of the Commercial Lease Act are mandatory; and parties may not derogate from said provisions.

Most leases for commercial purposes (offices, warehouses, factories, etc.) are governed by the general provisions of the Civil Code, since they do not fall within the scope of a specific set of rules (except for the leases for retail trade); we will therefore briefly review some of the general rules of the Civil Code and, when useful, will make reference to or comparison with the Commercial Lease Act of 30 April 1951.

i Term

Parties are free to agree on the term of leases. Written lease contracts concluded for a fixed term end automatically when the lease periods have expired, without prior notice.[3] The contracts may, however, provide for notice at the end; they may also provide break options for one party or both.

In the framework of retail trade legislation,[4] the terms of each lease must be at least nine years; however, tenants may terminate leases at the end of each three-year period, provided they give notice at least six months before the relevant termination dates. The lease may grant the tenant more termination rights but may not restrict them. If lease agreements explicitly so allow, landlords may also terminate agreements at the end of each three-year period if they wish to carry on their own businesses in the leased premises, or they want to allow their spouse, certain relatives or a company owned by such person to carry on a business in the premises. Landlords' notices to quit must be served on tenants at least one year before the end of the relevant three-year period. Parties may also terminate leases at any time by mutual agreement, but the agreements must be set down in a notarial deed, or be declared before a justice of the peace.

ii Rent and rent increases

The amount of the rent is determined freely by the parties, by mutual agreement. If the rent does not provide an indexation clause, it will remain unchanged throughout the duration of the lease. Parties may, however, explicitly stipulate that the rent will be linked to the cost of living (which is most common) or that according to a certain number of elements, the rent will be revised upwards or downwards.

The Commercial Lease Act of 30 April 1951 on the retail leases stipulates the possibility for each party to request the revision of the rent at the end of each three year-period. Each party is entitled to apply to the justice of the peace for a rent review at the end of such period, provided the applicant can prove that the normal rental value

2 Sections 1714 to 1762-bis.

3 Section 1737 of the Civil Code.

4 Commercial Lease Act of 30 April 1951.

of the premises has become at least 15 per cent higher or lower than the then-applicable rent, and that such increase or decrease is due to new circumstances that will have an impact on the rental value of the premises for at least three years (the improvement of the district, etc.). If parties cannot reach agreement, a justice of the peace may fix the rent equitably by looking at market conditions and the features of the building.

iii Renewal

The legal rules governing ordinary leases are silent on a right of renewal, but the parties are free to provide such a right in favour of tenants. In the absence of such provision, there is no automatic right of renewal.

With regard to retail leases, tenants have the statutory right to demand three lease renewals, each for nine years (although the parties may agree to renew for other term lengths).[5] Tenants wishing to renew retail leases must apply to their landlords, between 18 and 15 months before the lease ends by recorded delivery letter or by bailiff, indicating the conditions under which they wish to renew their leases; landlords then have three months to give notice of their decisions. They may take any of the following actions:

a expressly agree to renew;

b refrain from replying to the tenant's offer, in which case they are deemed to have agreed;

c impose other renewal conditions – if tenants reject them, they must bring the matter before a justice of the peace within 30 days of receiving the offer, otherwise they lose their rights to renewal; or

d validly refuse to renew on one of the grounds listed in Section 16 of the Commercial Lease Act.[6]

Landlords may also claim higher rents offered by third parties; however, if current tenants match these offers, they are preferred. If renewal is refused as described in item (d), tenants can claim compensation for disruption of their business tenancies in some cases and under certain conditions. Landlords have an absolute right to refuse renewal without motive, but if they refuse to do so without invoking a motive provided for under the law, they are liable to tenants for damages in an amount of at least three years' rent.

VII DEVELOPMENTS IN PRACTICE

i Space ownership: the vertical dimension of real property

A hot topic in Belgian real estate law practice is the space ownership or vertical dimension of property issue, which deals with the question of whether it is possible to split horizontally the property of the soil from the property of the subsoil and the above ground in order to pile up property rights vertically.

5 Section 13 of the Commercial Lease Act.

6 For example, personal occupation of the premises by the landlord, non-commercial use of the premises, required reconstruction works in an amount higher than three years' rent (with the main cause being attributable to the tenant).

This question cannot be answered without taking into account Section 553 of the Civil Code, which stipulates that all constructions, plantings and works on or within a piece of land are deemed made by the owner, at his or her expense and belonging to him or her, unless the contrary is proved. This is the right of accession, and it follows from this that the owner of a piece of land is deemed to be the owner of what is above and below it.

To realise the horizontal split, the owner of the ground must therefore renounce his or her right of accession. Such renouncement is, however, qualified by the Belgian Supreme Court as a building right regulated by the Belgian Act on Building Rights dated 10 January 1824. The major problem of the qualification as a building right lies in its mandatory temporal limitation to 50 years, meaning that no perpetual division of ownership can be realised above ground.

It has, however, long been admitted (since a decision rendered in 1969 by the Belgian Supreme Court) that such a split (without a time limitation) is possible between the soil and the subsoil. The reasoning is based on the literal interpretation of the concept of a building right as the right to have constructions, plantings and structures upon someone else's ground, which also means that nothing opposes a perpetual ownership under someone else's ground (i.e., the subsoil/the underground). It is debatable whether this possibility (perpetual division between the soil and the subsoil) will remain; indeed, the Parliament is due to modify the Act of 10 January 1824 to provide a wider definition of the building right as being also the right to have constructions under someone else's ground.

Some nuances are, however, conceivable in two situations in which a perpetual horizontal split of the ground (the above ground and the underground) seems to be possible.

The first situation is provided by Section 553 of the Civil Code, in which a third party acquires, by way of prescription, an underground space under a building of a third party, or of any other part of the building.

The second situation involves public state property, in which case, two hypotheses are conceivable. The most obvious hypothesis is that in which the soil belongs to a private entity and a construction above it (e.g., a viaduct) or beneath it (e.g., a pipeline) is public state property. Given the fact that, under Belgian law, no public state property can be acquired by prescription, the private owner will never be able to invoke his or her right of accession, thus creating in that respect a perpetual horizontal split of property rights. Another, more complex hypothesis is that in which a public body owns both the soil and the subsoil, with the soil being public state property (e.g., a public road) and the subsoil being private state property. In this hypothesis, it is conceivable that said public body sells its subsoil without being subject to the temporal limitation of building rights. This perpetual horizontal split is possible because of the preliminary split of the property regime of both the soil and the subsoil.

Further, it should be noted that on 13 September 2013, the Belgian Supreme Court decided that 'immovable ownership, independent from the ownership of the soil, can only be applied to constructions, structures and plantings'.[7] According to some

7 Cass. 13 September 2013, www.cass.be.

authors, this decision seems to be a confirmation by the Court that volume ownership is not possible. It is anticipated that this issue will continue to be heavily debated.

ii Proposal for a directive of the European Parliament and of the Council on credit agreements relating to residential property[8]

On 31 March 2011, a proposal for a directive on credit agreements relating to residential property was presented by the European Parliament and the Council.

The objectives of the proposal are twofold. First, it aims to create an efficient and competitive single market for consumers, creditors and credit intermediaries with a high level of protection by fostering consumer confidence, customer mobility, cross-border activity of creditors and credit intermediaries, and the submission of all creditors within the EU to the same rules. Second, it seeks to promote financial stability by ensuring that mortgage credit markets operate in a responsible manner.

The proposal was expected to be approved in the spring of 2012, but was in fact finally amended on 10 September 2013 and still has not been approved.

The main provisions of the proposal for the directive deal with:

a the financial education of consumers;
b conditions applicable to creditors, credit intermediaries and appointed representatives;
c the conduct of business obligations when providing credit to consumers;
d the obligation to provide information free of charge to consumers;
e the obligation of fair, clear, non-misleading and standardised advertising;
f the obligatory provision of pre-contractual information through the European Standardised Information Sheet (ESIS);
g the obligation to assesses the creditworthiness of the consumer and the disclosure and verification of consumer information;
h the possibility of early repayment; and
i prudential and supervisory requirements.

Its new Recital 7 and amended Article 2 provide that provisions laid down by the directive are subject to maximum harmonisation in relation to the provisions of pre-contractual information through ESIS. However, in those areas not clearly specified as being subject to maximum harmonisation, Member States should be allowed to maintain or introduce more stringent provisions than those laid down in the directive, provided that such provisions are consistent with their obligations under EU law. It is exactly in this regard – a lack of harmonisation – that Belgian doctrine criticises the proposal. There is too much leeway for the legislator, which unfortunately allows the maintenance of important differences within the consumer protection provisions in the different Member States.

8 COM(2011)0142-C7-0085/2011-2011/0062.

iii Rules on co-ownership

The Law of 2 June 2010 amended the Civil Code to improve and modernise the functioning of co-ownership and to resolve a number of difficulties that had previously occurred under the Law of 30 June 1994.

The most remarkable innovation is the provision for co-owner associations to create separate subgroups for separate buildings or for separate parts of a building; in other words, the ability to establish partial associations. Since co-ownership has become more complicated and more wide-ranging, the need for more efficient management of groups of buildings had arisen, and thus the need for a legal basis for such subgroups. Subgroups can now be formed provided that the main co-owner association consists of at least 20 individual parts. For a group of buildings, a subgroup can be created per separate building; for a building with physical divisions into distinct parts, a subgroup can be created for each part of the building. The partial associations need only be involved in respect of common areas intended to be used by some of the co-owners. The main association of co-ownership remains exclusively responsible for the general common areas and for the issues relating to the joint management of the co-ownership.

Partial associations can be established either with or without legal personality. To obtain legal personality, the basic deed and the regulation of co-ownership of the partial association must be registered at the Mortgage Registry Office.

iv Anti-abuse provision impact on split-sale transactions

Until recently (see Section IV, *supra*), the split-sale structure was a much used and very popular structure in Belgium for transferring control over immoveable property.

A split sale involves the vesting of a long-term lease right (against payment of a lump-sum price) to the benefit of one party and the transfer of the ownership encumbered with the long lease to another – possibly related – party. At the end of the long-term lease, the latter party obtains the full ownership of the real estate. If strict conditions are complied with, a split sale may involve a significant transfer tax saving. The transfer tax due in connection with the long-term lease was equal to 0.2 per cent of the amount paid under the long-term lease (by an Act of 28 June 2013, the transfer tax on long-term leases and on building rights has been increased to 2 per cent, with effect from 1 July 2013). The transfer tax due in connection with the transfer of the encumbered ownership is 10 per cent or 12.5 per cent (depending on the location of the property) of – as a consequence of the encumbrance – the reduced value of the property. Such structures were therefore very efficient from a transfer tax point of view, because the long-term lease right (previously taxed at a statutory rate of 0.2 per cent) represents the major part of the value of the property (70 per cent to 95 per cent), while the reversionary interest (taxed at a statutory rate of 10 per cent or 12.5 per cent) only represents the remainder. Legal certainty with respect to the transfer tax due in connection with the split sale could be obtained by way of an advance ruling of the Belgian ruling commission.

By the Law of 29 March 2012, Parliament introduced a new general anti-abuse provision to the Belgian tax law. The new anti-abuse rule provides that a legal deed (or series of legal deeds) is not binding on the tax authorities if they can demonstrate that tax abuse has been committed. For the purposes of the anti-abuse rule, tax abuse is defined as either a transaction the taxpayer enters, in violation of the purposes of a provision of the Income Tax Code, outside the scope of this provision; or a transaction that gives rise to a tax advantage afforded by a provision of the Income Tax Code whereby securing this tax advantage would be in violation of the purposes of this provision, and whereby the primary purpose of the transaction is to obtain the tax advantage.

In the event that the tax authorities contend that a legal deed should be considered abusive, the taxpayer must demonstrate that the choice for the legal deed (or series of legal deeds) is motivated by purposes other than tax avoidance. When the taxpayer cannot demonstrate the existence of other, non-tax related, motives for the transaction, the transaction will be subject to taxation in line with the purposes of the Income Tax Code, as if the tax abuse had not taken place.

For registration duties, the new anti-abuse rule applies to all legal acts carried out as of 1 June 2012; transactions completed before that date cannot, in principle, be challenged on the basis of the new anti-abuse rule.

Although the split sale is not specifically mentioned in the law, it was generally considered that its use would no longer be permitted to structure real estate transactions, and this has been officially confirmed by the Belgian tax administration circular of 19 July 2012.[9] A split-sale transaction is now blacklisted to the extent that the entities involved on the buyer's side are affiliated, which means that such transaction will be considered abusive unless the parties are able to demonstrate that the transaction was justified for purposes other than tax avoidance. The above-mentioned circular was replaced by a new circular of 10 April 2013, which maintains the blacklist but also adds a white list of transactions that are considered to be not fiscally abusive.

v New circular on the VAT regime applicable to shopping centres

While leases in Belgium are not generally subject to VAT, the operating activities of a shopping centre are. A lease relating to a shopping centre unit is to be distinguished from an ordinary lease, given that other services are provided along with the private units and spaces put at disposal in a shopping centre. The operation of a shopping centre could thus be subject to mixed VAT taxation.

By a circular of 29 October 2012,[10] the VAT administration has clarified the VAT regime applicable to shopping centres.

While, previously, some aspects of the operation of a shopping centre could be subject to VAT (e.g, services with regard to utilities and services relating to the management of the common spaces of the shopping centre), there was a legal uncertainty regarding the costs to which the VAT deduction applied; the VAT regime that applied on a shopping centre was always subject to an individual decision of local administrations or the central VAT administration.

With the aim of bringing uniformity and legal certainty to this matter, the circular provides that a distinction must be made between three operation activities, and that a different VAT regime is applicable on each operation:

a the lease of private units and spaces, which is exempt from VAT;

9 No. 8/2012.

10 No. 34/2012.

b services associated with the lease of the private units or spaces (e.g., utility services such as water, heating and cleaning), which may be charged with VAT as long as they are charged separately; and

c general services with regard to the common spaces (e.g., publicity, organisation of events and animation, reception of clients, maintenance and cleaning of the common spaces, safety and waste management), which are subject to VAT.

We can therefore conclude that a shopping centre is subject to mixed VAT taxation; whether a cost is subject to VAT depends on the qualification of that specific activity.

The question arises, however, whether this circular is in accordance with the jurisprudence of the Court of Justice of the European Union, which recently ruled, by a judgment of 27 September 2012, on whether the leasing of immoveable property and the supplies of services linked to that leasing must be regarded as constituting a single supply, entirely exempt from VAT, or several independent supplies, assessed separately regarding VAT. The Court of Justice decided that although the services in question (e.g., cleaning services, etc.) would not normally be considered to be the leasing of immoveable property, they could, nonetheless, be regarded as ancillary to that leasing; charges for cleaning and maintenance in respect of a commercial property lease are to be treated as part of the rental of that property, and therefore exempt from VAT, since in the current case the two charges were closely linked.[11]

vi Extension of joint liability for the tax, social and salary debts of a joint contractor

By the Law of 29 March 2012, the Parliament adapted and extended the system of joint and several liability for the tax and social debts of a joint contractor or subcontractor that has existed within the construction sector for a considerable time.

Prior to the extension of the system, a contractor could be held liable by the social inspection authorities or the tax authorities (or both) for the social debts or tax debts (or both) of a joint contractor or subcontractor; however, the liability was, in principle, limited to the invoice amount of the services delivered. The contractor could, however, prevent this liability by correctly applying withholding duty when contracting with a joint contractor or subcontractor with social debts or tax debts (or both): the contractor should withhold an amount of 35 per cent in the case of social debts and an amount of 15 per cent in the case of tax debts of the joint contractor or subcontractor at the time of payment.

This system has been extended, with the Law of 29 March 2012 introducing a mechanism of ultimate responsibility to higher-ranked actors. Before the new Law, a principle (contractor) was only liable for the next contractor or subcontractor in the chain. However, following the introduction of this secondary liability, if a jointly liable contractor cannot settle the social or tax debts of the joint contractor or subcontractor, someone else in the chain shall subsequently be called upon and be held liable. As such, a contractor that has correctly withheld the 15 per cent or 35 per cent can still be held

11 *Field Fisher Waterhouse LLP v. Commissioners for Her Majesty's Revenue & Customs* (Case No. C-392/11).

subsidiarily jointly liable. Furthermore, the liability also applies to the salary debts of the contractor. This was implemented by the Royal Decree of 23 May 2013 in execution of the Law of 29 March 2013.

An Act of 11 February 2013, which entered into force on 4 March 2013, introduced a specific joint liability of employers of illegally staying third-country nationals (i.e., non-EU citizens). Three situations of joint liability are conceivable in this context:

a The first is the situation of the joint liability of the direct contractor, where the contractor or the next contractor is jointly liable for the salary debt resulting from the employment of illegally staying third-country nationals by his or her direct subcontractor.[12] However, joint liability does not apply if the contractor or next contractor is able to submit a written statement of his or her direct subcontractor in which the latter declares not to employ illegally staying third-country nationals.

b The second is the situation of the joint liability of the indirect contractor, meaning that the contractor and next contractor are jointly liable for the salary debt resulting from the employment of illegally staying third-country nationals by the subcontractor of their subcontractor (i.e., his or her indirect subcontractor), but only in cases where they were aware of it.[13]

c The third situation is the situation of the joint liability of the principal, meaning that the principal will be hold jointly liable in cases where he or she was aware of the employment of illegally staying third-country nationals by his or her direct or indirect contractor or subcontractor.

VIII OUTLOOK AND CONCLUSIONS

The eurozone sovereign debt crisis was identified as the biggest threat to the Belgian real estate market in 2012.

During 2013, however, economic sentiment improved, and risk aversion was no longer the main focus. The Belgian economy was no longer in recession at the end of 2013, showing a 0.2 per cent GDP growth rate.

As a result, it seems that offices are coming back into favour for investors; for the first time since the economic crisis, investors are willing to invest in offices again (the office segment in 2013 will represent 65 per cent of all investment, against 50 per cent in 2012).

Even though the general sentiment of 2013 is cautiously positive with regard to the Belgian real estate market, the governmental budget is still, as in many other countries, under pressure, and the government is in need of additional funding. During 2012–2013, the government implemented new laws that had an important impact on the real estate market (the anti-abuse provision's effect on the split-sale structure). We expect the government will be obliged to take further action in the course of the next year and will continue taking measures that, inevitably, have an impact on the real estate market.

12 The chain of contractors is as follows: contractor – next contractor – subcontractor – indirect subcontractor.

13 Ibid.

Chapter 3

BRAZIL

Marcelo José Lomba Valença and Tamiris Micheletti Britzki[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

Title to real estate in Brazil means not only the right to use, receive revenues and convey, but also the obligation to use the real estate in the most appropriate way to maximise both economic and social benefits. The result of these activities must not have any adverse impact on the environment, or on the urban or historical surroundings in which the real estate is located.

The most common types of real estate ownership interests held exclusively or concurrently by private persons or entities are non-subordinated interests – ownership; and subordinated interests – surface rights,[2] *emphyteusis*, equitable interests,[3] mortgages, pledges,[4] easements and usufructs.[5] There is only one non-subordinated interest, which

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2 Surface rights are generally established between entities for a certain period and a consideration is payable by the grantee to the grantor. Essential to surface rights is the requirement that the grantee give back the real estate at the end of the surface rights term with all improvements made and without any payment.

3 Equitable interest is applicable when a seller conveys the real estate to a purchaser and agrees that the latter pay the former the acquisition price in instalments. Each instalment paid by the purchaser of the acquisition price is incorporated into the purchaser's equitable interest in the property. Upon payment of all the instalments, the purchaser may convert its equitable interest into ownership interests, regardless of the seller's consent.

4 Pledge interests are quite similar to mortgages; however, they apply only to moveable assets.

5 Usufruct is very similar to surface rights; however, it is generally established between natural persons for life and without consideration.

is ownership. Subordinated interests are constituted upon the ownership interest of a certain person or entity.

All real estate in Brazil has a specific record filed at the Real Estate Registry, which determines real estate ownership matters. For the purposes of constituting interests in real estate, it is mandatory to register the title document in the property record. Brazil operates on a first come, first served basis: whoever records first has the senior interest to the real estate ownership, regardless of the date on which the relevant title was executed. There is no title insurance in Brazil. According to Article 236 of the Constitution, the government grants concessions to Real Estate Registry offices for providing the records that attribute title to private individuals and public and private entities in the country. Real Estate Registry officers are liable for any suits lost with respect to their activities concerning real estate interests and the granting of title.[6]

The constitution of real estate ownership interests in Brazil is achieved in two stages: attachment, which occurs upon execution of the relevant title and is binding only upon the parties who signed the document (conveyor and conveyee); and perfection, which occurs upon the registration of the title in the property record, rendering the title valid for third parties.

The law that applies to cases involving real estate ownership interests is the Federal Civil Code, regardless of whether the parties choose any other applicable law.

II OVERVIEW OF REAL ESTATE ACTIVITY

Brazil's GDP in 2013 was US$2,190 trillion, to which the real estate industry contributed just US$68 billion. However, Brazil's real estate industry is the second preferred investment opportunity for foreign investors (the first is the oil and gas industry), and in 2013, Brazil's real estate industry received foreign investment amounting to US$3 billion. Continued revenue from household incomes reflects the demand for real estate: from July 2012 to June 2013, there was an increase of 4.52 per cent of housing units delivered compared with the period from July 2011 to June 2012. Improvements made in the Brazilian financial system contributed substantially to the increase of house financing: from July 2012 to June 2013, there was an increase of 20.22 per cent of housing financing disbursed.

The Brazilian internal rate of return in the real estate industry is at least twice as high as that in the United States and China. Brazil has 90 real estate investment trusts (REITs) holding US$2.4 billion in assets. Such type of investment is incentivised by the government through tax exemptions on both the income of resources to the REIT and also on the distribution of dividends to quota holders. The liquidity of these REITs, measured by the volume of transactions held in 2013, represents 20 per cent of the REITs' assets.

Finally, Brazil is now ranked fourth in the world ranking of green buildings.

6 Article 22 of Federal Law 8,935/1994.

III FOREIGN INVESTMENT

There are no restrictions on foreign investors acquiring quotas of REITs, FAR certificates, or even shares in real estate development or real estate construction companies in Brazil. Nor are there are any restrictions on the direct acquisition of urban real estate in Brazil by foreigners.

There are restrictions, however, on direct acquisition of rural and federal land in Brazil by foreign nationals. The political aspect of this issue is reflected in the history of legally binding ordinances restricting or allowing acquisition of rural land by a corporate vehicle incorporated in Brazil and controlled by foreign nationals: from 1971 to 1995, there were restrictions; the restrictions were lifted from 1995 to 2008; and from 2008 to August 2012, restrictions applied again.

On September 2012, the São Paulo State Court of Appeals (the TJSP) determined that if Brazilian companies with foreign capital registered at the Property Registry Office merge with a company that has rural properties, then such properties could be transferred to the Brazilian company with foreign capital.

In Opinion No. 461/2012-E, the National Board of Justice determined that the judiciary as a whole should accept the decision of the TJSP, and recognise that the restrictions on Brazilian companies with foreign capital in the matter of the acquisition of rural property have not prevailed since 1988.

Notary publics and registrars affiliated to the judiciary are released from regarding the restrictions and determinations imposed by Law No. 5,709/71 in cases of Brazilian legal entities whose majority share capital is held in the hands of foreign nationals residing outside Brazil or of legal entities with head offices abroad.

IV STRUCTURING THE INVESTMENT

One of the most common structures adopted by foreign investors interested in real estate assets or development in Brazil is the private equity fund, incorporated with at least three investors, none of which holds more than 40 per cent[7] of the capital of the fund and who are not located in tax havens. Funds such as these can invest in shares in special purpose vehicles (SPVs) that may own, market and develop real estate projects. The dividends distributed by the SPVs to the funds are tax-exempt at fund level. Investors are not taxed on the payment of dividends made by the fund or on the repatriation of capital invested; this results in the lowest possible level of taxation. It is necessary, however, to have at least three investors to avoid a concentration of capital higher than 40 per cent among investors, and it is necessary to have a bank as general partner of the fund. The tax assessed on such operations is a financial transaction tax (IOF tax),[8] payable by the foreign investor upon the execution of the foreign exchange agreement to convert the

7 Article 3 of Law 11,312/2006.

8 The IOF tax rate can vary from zero to 6 per cent over the exchanged amount. On 16 January 2012, the IOF rate was zero for FIP operations.

investor's original currency into Brazilian local currency for the purposes of capitalising the fund.

Direct investment in a real estate SPV is taxed under the system of assumed profit. Under this system, the real estate SPV pays an amount equivalent to 15 per cent of the rent proceeds or 6.73 per cent of the proceeds from the sale of assets, in both cases at the corporate level. The repatriation of the invested capital as dividends is tax-exempt. The advantage of this alternative is that there are no restrictions on the concentration of capital in the hands of a single investor and there is no need for a general partner; however, this structure is limited to an annual cap of 48 million reais.

Investment in REIT quotas (FII quotas) or real estate asset-backed bonds (CRIs) is also possible. In contrast to the private equity fund and the SPV, the general partner of the REIT or the issuer of the CRIs has control over the use of the resources and the payment of dividends, and the investors have no control over the investment, assets or distribution of dividends; however, there is total segregation of operational risk for the foreign investor. The general partner or the issuer of the CRIs, as the case may be, is liable for all aspects of the investment. The taxation rate for FII quotas or for CRIs upon the distribution of dividends ranges from zero to 20 per cent for non-domiciled legal entities. The tax assessed on these operations is the IOF tax.

To offer CRIs in the capital market, regulations stipulated by the Securities and Exchange Commission of Brazil (CVM) must be observed. CVM Instruction No. 400 regulates public offerings of securities, which are usually registered with the CVM.[9] CVM Instruction No. 414 differentiates between a public offering of CRIs with a unit value equal to or over 300,000 reais[10] and a public offering of CRIs with a unit value under 300,000 reais.[11] With the issuance of CVM Instruction No. 476 in 2009, the public offering of some securities, including CRIs, became much easier in a fast-track scheme, which may be applied to a public offering carried out under a restricted selling efforts regime that is only open to qualified investors.[12] These public offerings are not

9 This registration depends on the CVM analysis of an extensive set of documents that must be prepared by the issuer of the CRI and others involved in the deal. Some documents must be published in the newspapers in which the issuer normally publishes its notices, and the preparation of a prospectus is required.

10 In this case, rating by a rating agency is not necessary; after 18 months of its offer, the CRI may be divided into CRIs with a unit value under 300,000 reais.

11 In this case, the CRI issuance must be backed by credits subject to issuance trust, the credits should result from the sale or lease of performed real estate projects, and rating is necessary.

12 According to Article 109 of CVM Instruction No. 409, the following are considered qualified investors: (1) financial institutions; (2) insurance companies and capitalisation societies; (3) private welfare open or closed capital organisations; (4) natural or legal persons that hold financial investments in an amount greater than 300,000 reais and that additionally attest in writing their qualified investor status according to a specific instrument; (5) investment funds directed exclusively to qualified investors; (6) portfolio administrators and securities consultants authorised by CVM, in relation to their own monies; and social security regimes instated by the federal government, the states, the federal district or the municipalities. For the

required to be registered with the CVM and have lower costs, fewer documents are required to be published in the newspapers and the preparation of a prospectus is not necessary. In a fast-track public offering, a maximum of 50 qualified investors can be approached, but the securities offered can only be subscribed or acquired by a maximum of 20 qualified investors. Another relevant limitation is the 90-day blackout period following the subscription of the securities, in which the securities cannot be traded in the regulated market.

V REAL ESTATE OWNERSHIP

i Planning

The use of urban land is subject to the municipal Rules on Subdivision, Use and Occupation of the Land (LPUOS) and to the Works and Building Regulations (the LOE). Each city has its own LPUOS and LOE. LPUOS is a set of rules that basically defines which construction works and activities may be carried out in certain municipal areas, whereas the LOE sets out how each construction work must be conducted. The LPUOS system divides the city into zones in terms of use, determined by demographic and environmental criteria. Each zone is subject to its own land occupation rules. Land occupation is determined by urban ratios and profiles as follows: setbacks, the built-up area to land area ratio (density), and the coefficient of land use by buildings (land use). Consequently, in zones that are not to become densely populated, the density and land use must be low, and vice versa. LPUOS also categorises areas in terms of use. As soon as zones and uses are classified, LPUOS determines which activity may be developed in each zone. More than one use is acceptable on the same property if such uses are expressly authorised for the respective zone and each use fulfils the respective requirements in terms of urban ratios and profiles. An exception to this rule is the use sometimes related to garages, wholesale activities, medium-sized and large industries, and housing projects.

If the intended use is commensurate with the zoning rules, then the LOE will stipulate how the project must be built. As a rule, the approval and completion of works will be contingent upon the issuing of a plan approval permit, plan performance permit and work completion certificate. The first two are generally obtained jointly, whereas the third document is obtained after completion of the works when the City Hall inspectors verify that the works are in line with the prior permits. Having obtained the completion permits, the following are also required: an inspection notice issued by the fire department, and a use and operation permit.

ii Environment

Federal, state or municipal authorities can issue environmental permits. The issuing authority is determined either by the matter requiring the permit or by the jurisdiction. Every application for a permit has to be considered separately as jurisdiction can change from city to city. Once jurisdiction has been established, the procedure can be initiated.

purposes of the fast-track scheme, item (5) above shall be considered as all investment funds, even if not directed exclusively to qualified investors.

Permits are granted at three different stages: before submission of a request for approval of a construction project (pre-licence); after approval of the project has been granted and before the start of construction (installation licence); and after completion of the construction (operating licence). The pre-licence provides an assurance to City Hall – which will later approve the construction of the real estate development – that the project follows the federal, state or municipal environmental guidelines. The owner or the real estate developer must, therefore, present the pre-licence when applying for project approval.

The installation licence permits the construction of the real estate development, and the operating licence is used to assess whether the developer is qualified to perform that type of operation and whether the choice of location for the development meets the relevant legal requirements. Each location has its own way of dealing with licensing and must be analysed separately. With respect to environmental liabilities, there are three different types of penalty:

a a tax penalty, which, basically, the authorities apply to those who do not pay due regard to the procedure; this can range from 50 reais to 50 million reais;

b a civil penalty, which is applied when some kind of damage is caused to the environment beyond any foreseen in the environmental licence; and

c a criminal penalty, which can be applied to anyone committing any of the crimes provided for in legislation, such as exercising an activity without the proper licence.

The penalties described in (a) and (b) can apply to any of the parties involved in the chain of events. Although it may be the tenant of a property who is responsible for damaging the environment, the authorities can find the landlord guilty of such damage. To establish a business in any Brazilian city, one must verify the feasibility of the business in terms of the usage zone, permitted use, safety rules, and rules on heritage, landscaping and environmental conservation.

iii Tax

Urban real estate is subject to municipal property tax (IPTU) and other charges (electricity, water, cleaning, etc.). Rural real estate is subject to rural property tax (ITR). These taxes, which fall under municipal and federal jurisdictions respectively, are calculated by applying a percentage to the value as assessed by the municipal government or by the National Institute for Rural Settlement and Agrarian Reform. The IPTU and ITR taxes are collected by enrolling the real estate in the specific taxpayers' register. Transfer tax in most cities is equivalent to 2 per cent of the purchase price or the assessed value of the property, whichever is higher. The *laudemium* tax relating to federal lands is levied at 5 per cent of the purchase price or the assessed value of the real estate, whichever is higher. The notarial and Real Estate Registry fees are calculated on the price of the property, and in the state of São Paulo they represent approximately 1.4 per cent of the purchase price or the assessed value of the property, whichever is higher. The transfer tax is a municipal tax that changes from city to city, as do the notary publics' and Real Estate Registry's fees. In the latter case, these charges fall under the jurisdiction of the state, and change from state to state.

iv Finance and security

The most common type of security in real estate in Brazil is the mortgage. Mortgages can be governed by lien theory or title theory. The lien theory mortgage is governed by the Civil Code, it can be granted in different degrees and any foreclosure must go through the courts. Once a property is mortgaged under the lien theory, it can be subsequently mortgaged or conveyed to the mortgage register in the property record. Lien theory mortgages in Brazil are traditionally associated with the slowness of the Brazilian judicial system. Mortgages under title theory (*alienação fiduciária*), according to Federal Law 9,514/97, do not allow for different degrees. Once the property is mortgaged under title theory, it cannot subsequently be mortgaged or conveyed to the mortgage register in the property record. Foreclosures on mortgages taken out under lien and title theories take around three years and nine months, respectively.

VI LEASES OF BUSINESS PREMISES

The leasing of urban buildings is governed by Federal Law No. 8,245/91 (the Tenancy Law) and the changes made by Federal Laws No. 9,256/96, No. 10,931/2004, No. 11,196/2005, No. 12,112/2009 and No. 12,744/2012. According to this legislation, leases are classified into two main groups: leases for residential use and leases for non-residential use. The following general rules apply to leases for non-residential use.

The amount of the rent should be stipulated in reais and is subject to annual monetary adjustment calculated by official indices that reflect the variation of prices. The term of the lease must be stipulated in the agreement. If, after the end of the term of the lease the tenant wishes to remain in the property with the landlord's consent, the lease is deemed extended for an indeterminate period and may be terminated at any time by either party by means of prior notice given 30 days before the date on which the property must be returned.

The landlord may not terminate the lease in advance of the expiry of the lease term. The tenant, however, may terminate the lease by acceleration by providing the landlord with prior notice 30 days before the date on which the property must be returned and will pay the stipulated contractual fine for such.

Lease-related expenses (property tax, insurance and amounts charged for utilities provided to the property, such as electricity, water and gas) are payable by the tenant. The tenant is responsible for maintaining the property and the landlord is responsible for any structural repairs. Any alterations made by the tenant in the building must be authorised by the landlord and, in accordance with market practice, the tenant is not entitled to any indemnification or withholdings for any improvements the tenant has made to the property.

Subleases, assignments or loans for use of the leased property are possible with the landlord's consent. For a lease to remain effective in the event of the alienation of the property, the agreement must contain an effectiveness clause and be registered with the relevant Real Estate Registry. If the lease agreement is not registered, the acquirer of the property need not respect the lease. The tenant has the right of first refusal to acquire the leased property, regardless of the length of the lease term.

Either party may require a rent review to bring it into line with market practices after three years of the lease term have elapsed and if adjustments of the lease amount are realised according to the legal indices, except as provided in Law 12,477/12 (see Section VII, *infra*). Should the parties fail to reach agreement on this, a court-appointed expert can assess the real market value of the rent.

The tenant may cause the compulsory renewal of the lease by means of a specific legal procedure – the lease renewal action – if:

a the agreement was executed in writing and for a determinate term;

b the agreement has a term of at least five consecutive years, which may comprise the sum of uninterrupted terms; and

c the tenant has performed the same activity in the property for at least three years.

If these requirements are met, the lease renewal action may be filed within 12 and six months prior to the end of the term of the agreement. If the lease renewal action is not filed during this period, the tenant forfeits the right to compulsory renewal.

VII DEVELOPMENTS IN PRACTICE

i Porto Maravilha

The most important development in real estate law and practice is the legal and economic package created by the City Hall of Rio de Janeiro, together with CEF, for the urban redevelopment of Rio de Janeiro's port area, the Porto Maravilha project. The Rio de Janeiro Municipal Complementary Law (the PM Law)[13] applies to an area of 5 million square metres along the port of Rio de Janeiro, and allows the building of an additional area of 4 million square metres upon the acquisition of FAR certificates.[14] The company developing the port area (CDURP)[15] is controlled by the Rio de Janeiro City Hall and may also have private investors. CDURP will manage the execution of infrastructure works necessary for the implementation of the PM Law, and provide the property management of the public areas resulting from the port redevelopment. CDURP will hire private entities under the public-private partnership (PPP) system for the execution of the works and the performance of the property management. All FAR certificates were transferred to CDURP by the Rio de Janeiro City Hall as capital. CDURP then transferred the FAR certificates to the REIT set up for the redevelopment (FII/RP)[16] together with the sites it received from the federal government. FII/RP sold the FAR certificates to a REIT controlled and capitalised by the federal government (FII/FGTS),[17] and also transferred

13 Law No. 101, enacted on 23 November 2009 – Porto Maravilha Urban Operation Law.

14 FAR Certificate Public Issuance Indenture, registered at the Securities and Exchange Commission of Brazil on 20 May 2011.

15 Companhia de Desenvolvimento Urbano da Região do Porto do Rio de Janeiro, created by Rio de Janeiro Municipal Complementary Law No. 102, enacted on 23 November 2009.

16 Fundo de Investimento Imobiliário da Região do Porto, registered at the Securities and Exchange Commission of Brazil on 27 December 2010.

17 Fundo de Investimento – Fundo de Garantia do Tempo de Serviço.

the sites within the port perimeter to FII/FGTS. The proceeds from the sale of the FAR certificates to the market, and the profits from the real estate development on the sites now owned by FII/FGTS, will be used to pay for the PPP agreement covering execution of the public works and expropriation of the private areas inside the port perimeter.

ii Infrastructure debentures

Federal Law No. 12.431/2011 created infrastructure debentures; this Law, regulated by Decree No. 7.603/2011, was implemented to create a more flexible process for the issue of debentures, enabling the formation of a more dynamic secondary market to boost the trading of these instruments considered essential to achieving long-term financing in the Brazilian economy.

Infrastructure debentures have been created to promote the implementation of investment in infrastructure projects, or of projects of intensive economic production in research, development and innovation, by granting tax advantages to the acquirer of the debenture. The debentures will be issued by special purpose entities (SPEs) and companies that control SPEs, such as concessionaires and permit holders of public services.

Tax benefits apply to the acquirer of the debentures: zero income tax accrues on the interest payable by the debenture when it is held by natural persons; and 15 per cent income tax accrues on the interest payable by the debenture when it is held by a legal entity (prior to 2011 the taxation for ordinary debentures was 22.5 per cent).[18] This benefit applies to debentures issued from 1 January 2010 to 31 December 2015.

The infrastructure debentures shall be issued by public distribution, in accordance with CVM Instruction No. 400, with a deadline of 31 December 2015. Federal government approval will be required for infrastructure projects financed by the issue of debentures. Infrastructure debentures are being used mainly in the construction of highways, but they can be used for financing railways, ports, airports, urban mobility projects, etc.

iii Covered bonds

Commercial banks can issue covered bonds that consist of a promise of payment in cash, and are registered, transferable and freely negotiable (*letras financeiras*). The certificates can be backed by title or lien mortgages (guarantees). The guarantees are attached to the corresponding covered bonds. The payments of the covered bonds are linked to the amortisation of the credit agreements secured by the guarantees. If the bond issuer does not perform according to its obligations in respect of the bonds, or if the issuer bankrupts, the credit agreements secured by the guarantees are preserved and liquidated to pay the holders of the bonds.

iv Built to suit

Leasing property under a built-to-suit model is a real estate investment variant in which supply precedes demand. The tenant commissions the landlord (in this case, a real estate

18 Law No. 11,033/2004, Article 1st, I.

investor) to provide a business unit at a location of the tenant's choice and according to the tenant's design. What distinguishes an ordinary lease (see Section VI, *supra*) from a built-to-suit lease is that in the first, the rent is the consideration solely for the use of the leased property, whereas in the built-to-suit lease, rent is both the consideration for the use of the leased property and the return on the investment made by the landlord to satisfy the needs of the tenant. Assuming that the rent is the consideration for the investment, it needs to be paid in full, for the entire term of the corresponding lease agreement.

There has been discussion of the possibility of the landlord collecting the balance of future rents from the tenant in the event of early termination of the lease agreement by the tenant. According to the default rule of the Tenancy Law, the tenant may terminate the lease by acceleration by providing the landlord with prior notice 30 days before the leased asset must be returned and paying the fine stipulated in the lease agreement reduced *pro rata* to the term of the tenant's occupancy.

In December 2012,[19] clear rules for built-to-suit lease agreements were established. In leasings of this type, the conditions freely agreed in the respective lease agreement shall prevail. Furthermore, both tenant and landlord can refuse the right to review the rent amount (see Section VI, *supra*), and the penalty for early termination may be equal to the future rents up to the end of the lease term, to reimburse all investments made by the landlord.

v Lease eviction procedure

In 2009, the rules related to the eviction of delinquent tenants was amended. It is important to note that, under Brazilian law, the single way to evict delinquent tenants from leased property is under a judicial procedure called a lease eviction. It usually takes around 12 months from the start of such procedure until the issuance of the eviction order by the judge. The amendment of the rules consists of a fast-track procedure for eviction. Under such fast-track procedure, the landlord deposits in court an amount corresponding to three months of rent effective at the time of the procedure filing. The purpose of such deposit is to secure any liquidated damages that may result from the fast-track procedure. Once the deposit is made, the judge sends an eviction notice to the delinquent tenant without summoning such delinquent tenant. Upon receipt of such eviction notice, the delinquent tenant will have 15 days to cure the delinquency or leave the leased property, under penalty of effective eviction by the police authorities.

Such fast-track procedure has not been used much in view of the need for the landlord to deposit the above-mentioned three-month rental amount. However, in December 2013, a REIT obtained a fast-track eviction notice and evicted, within one week, a plant for processing food consisting of 7,225m^2 of built up area. The eviction was executed by police officers, and the tenant's assets and inventories removed in trucks. This case has created a precedent for using the legal tool of the fast-track eviction procedure.

19 Law 12,744/12.

VIII OUTLOOK AND CONCLUSIONS

From 2000 to the present, the legal, economic and environmental requirements for real estate development have been amended to become more favourable, friendlier and safer for local and foreign investors.

The investment of private and public money to finance public works, housing for all levels of income and commercial and service buildings in the urban redevelopment of Porto Maravilha exemplifies the use of the most sophisticated structures and vehicles available in Brazil to maximise land use in terms of sustainability and wealth-distribution.

Driven by the My House My Life programme and the reduction in interest rates, housing finance availability swamped the market. The real estate development industry needs to be boosted by foreign capital to meet the demand for housing in Brazil.

Of note are the transparency and favourable taxation rules regarding REITs, CRIs, infrastructure debentures and covered bonds; these structures allow, *inter alia*, the segregation of risk for foreign investors and protection against bankruptcy – attributes applicable to real estate and infrastructure developments, and their financing. Fast-track procedures, too, are being created to reduce costs and expedite the terms of issuance of the securities mentioned.

The judiciary's stance sustaining the possibility of acquisition of rural land by corporate vehicles incorporated in Brazil and controlled by foreign nationals is the first step towards globalising the production of agricultural commodities.

Changes in the Tenancy Law to regulate built-to-suit lease agreements, as well as to expedite the delinquent tenants eviction procedure, will also encourage major investment commitments in the real estate market.

Chapter 4

CAMBODIA

Sophealeak Ing[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

As defined in Article 138 of the Civil Code, which became enforceable in late 2011 (the Civil Code), ownership is the lawful right to freely use, enjoy and alienate property. In principle, there is no distinction between ownership of land and ownership of the buildings on the land. However, for a specific period of time, land ownership does not cover any buildings erected thereon by any rights holders (other than the owner), based on their lawful rights in respect of the land (e.g., a lessee under a perpetual lease) (see Section VI, *infra*).

Immoveable property ownership can be categorised into different forms, such as co-owned buildings and boreys (gated housing communities each comprising lots, residences, other constructions, public spaces and infrastructures), which are subject to different legal regimes. For example, the owners of private units of co-owned buildings are entitled to exclusive ownership of their respective private units, as well as to undivided ownership of the common areas of the building.

According to the current land administration system, a landowner's definitive ownership over immoveable property is only legally recognisable in respect of property that is duly registered in the Land Register (i.e., property in which the title certificate, known as the hard title, is issued by the relevant cadastral office). Ownership data on registered immoveable properties is managed by the state by way of the Land Register, which is maintained at the cadastral office. Any transfer, change, rectification or termination of immoveable property ownership is required to be recorded in the Land Register.

In contrast, ownership is not legally recognised in respect of property that remains unregistered. Only a possessory right, known as a right to actual occupation

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of the property, is held by the possessor of the land. In current practice, unregistered property can be identified through certain land-related documents issued by the local administrative authorities known as soft titles. Consequently, through a lawful possessory right existing for a specific period, this may lead to the formation of ownership and the necessity for the possessors to register their ownership in the Land Register.

ii Systems of registration

The existence of different land registration systems in Cambodia is historical. Following the destruction of land records during the 1975–1979 political regime, Cambodia decided in its legal framework not to legally recognise the distribution of land that existed before 1979. Until 1992, legal ownership was only recognised for residential land and houses, while ownership over agricultural land was seen as a possessory right. However, since 1992, ownership has been legally recognised for both residential houses and agricultural land, and registration of this ownership can be done through the sporadic land registration process, which is defined below. Considering both the importance of land registration for determining people's legal rights and the fact that most land parcels are unregistered, the state formerly decided to establish another land registration system in 2000, followed by a revision of its legal framework in 2002.

Sporadic land registration

Sporadic land registration is a registration process for individual land parcels. The process is initiated by an interested applicant, who is responsible for all costs and expenses incurred in connection with the process. Despite it being concerned with individual land parcels, the process of sporadic land registration requires proper cooperation and assistance from the neighbours of the surrounding properties of the target land and the competent local authorities, especially in order to conduct boundary demarcation. Therefore, the success and length of the registration process may also depend on their availability. At the end of the procedure, the cadastral office provides the applicant with an ownership certificate for the residential house and a possession certificate for any agricultural land. The sporadic land registration process still exists at present, regardless of the establishment of the new land registration system (i.e., the systemic land registration process).

Systemic land registration

Systemic land registration is a collective land registration process that involves simultaneously registering numerous land parcels in a defined adjudicative area. The process begins with the identification and determination of the adjudicative area by the cadastral administration followed by the collection and publication of data of land parcels collected in such adjudicative area, through which any claims or disputes in the area can be raised to the officials and thereafter resolved. The procedure is completed by the issuance and distribution of ownership certificates for the immoveable property (land management and administration project certificates (LMAP certificates), which are the latest form of land ownership certificates). Following the completion of registration for land and houses that have been registered under the sporadic land registration process, landowners have to exchange their existing land title certificates for LMAP certificates. In addition, for those who have failed to participate in the systemic land registration process, they may apply for registration of the properties on a separate and individual basis and at their own cost and expense, through the sporadic land registration process.

iii Choice of law

The Cambodian legal system adopts a general principle according to which most of the legal provisions relating to property are of a public order nature. Therefore, unless otherwise provided by a specific legal provision itself, the Cambodian legal provisions on real property, such as those related to real security rights and the enforcement thereof, constitute the minimum provisions that govern transactions concerning immoveable property.

II OVERVIEW OF REAL ESTATE ACTIVITY

The past 12 months saw a significant injection of direct foreign investment into the Cambodian market in the form of either property developments or the acquisition of shares, assets, or both. Phnom Penh in particular is experiencing a construction boom with new restaurants, offices, serviced apartments, shopping centres, hotels, hospitals and schools. Approval rates for construction work in Phnom Penh provide strong evidence of slow but stable growth in the sector. According to the Ministry of Land Management, Urban Planning and Construction, investment capital in the construction sector increased 31 per cent in 2013 compared with 2012.

One of the most significant construction projects is the Aeon Mall in Phnom Penh; with a cost exceeding US$200 million, it is due to open in July 2014.

Vattanac Capital Tower is due to open (also in Phnom Penh) in spring 2014, and will consist of, *inter alia*, 21 floors of grade A office space, a retail zone and a five-star hotel.

In September 2013, Hongkong Land (HKL) launched a US$100 million mixed-use development project in Phnom Penh's financial district. The Landmark building will be situated on a 10,700 square metre area. HKL also entered into the Cambodian property market in 2013 with the launch of Central Mansions, again in Phnom Penh.

In 2013, the island of Koh Russey was confirmed as the first internationally branded island resort to be built in Cambodia. The first phase of the development is expected to be completed in 2015, with the project set to become a pioneering development on Cambodia's coastline. A similar construction project includes a high-end property project on the island of Koh Pos, with costs of up to US$1 billion.

Among many high-profile development projects owned by South Korean investors, the US$1.1 billion Booyoung Town project, owned by South Korean conglomerate Booyoung Group, started in 2013, and is expected to be completed in seven years. Considered to be the biggest construction project in 2013, it will include commercial buildings, residential buildings, a school and sport facilities.

2014 began with a high-profile joint investment between a Singapore-listed property developer, Oxley Holdings, and a Cambodian partner to build The Bridge, a US$300 million twin-tower commercial building.

Cambodia has also experienced a surge of strong interest from foreign investors in agroindustrial sectors. A number of economic land concession projects have been approved and in active development during the past five years.

III FOREIGN INVESTMENT

Under Article 44 of the Constitution and Article 8 of the Land Law 2001 (the Land Law), a foreign national is prohibited from owning any land parcel in Cambodia. However, a foreign national may own any private units of co-owned buildings that are established in accordance with the laws and regulations on co-owned buildings.

Other than owning land, foreign investors may operate any business activities in the real estate and construction sectors, such as a real estate service or construction and property development, if they have themselves invested 100 per cent into the activity, or have jointly invested with local stakeholders.

As a general principle, investment in real estate and construction *per se* does not qualify any investor to obtain any tax incentives under the national investment law. However, investment in certain projects that meet the criteria of qualified investment projects (e.g., construction of a mall or commercial centre, international exhibition centre, conference hall, luxury hotel) could mean that the individual is entitled to tax incentives under the national investment law.

IV STRUCTURING THE INVESTMENT

i Form of business

To invest in Cambodia, a foreign investor may establish a new company, subsidiary or branch office under the national laws. The new company or subsidiary may be in the form of a public limited company, private limited company or a single member private limited company. In accordance with the concept of limited liability, the parent of a subsidiary remains liable for its subsidiary's debts and liabilities only to the extent of its subscribed capital in the subsidiary. With regards to a branch, the same business activities in Cambodia can be carried out under the name of the principal as a foreign company: however, the principal of a branch cannot enjoy the limited liability of the parent company.

In addition, a foreign company may establish a representative office (RO) in Cambodia to facilitate certain limited activities and services of its principal for a specific period of time. However, an RO is not considered a separate legal entity from its parent company; therefore, it is prohibited from undertaking in any profit-generating activities in Cambodia. Permitted activities of an RO include introducing customers to its principal, researching commercial information for its principal and conducting market research.

ii Share acquisition

A foreign investor may opt to acquire shares in an existing company (target company). In such case, a shareholding percentage of at least 51 per cent of the total voting shares in the target company must be held by a Cambodian individual or legal entity to ensure the validity of the target company's ownership over the land.

iii Land acquisition

A foreign investor may also opt to create a new company to acquire immoveable assets. In such case, only companies where 51 per cent or more of the total voting shares are held by a Cambodian individual or legal entity can own land in Cambodia. Proper arrangements have to be put in place to protect the interests of the foreign investor. In this regard, consultation with and advice from a highly qualified professional are strongly recommended. If the land acquisition is not necessary, there are certain ways for a foreign investor to use and enjoy land in Cambodia.

iv Acquisition of rights to use and enjoyment of land

The investor may lease immoveable properties for their investment purposes. The lease of an immoveable property for 15 years or more is considered as a perpetual lease. A perpetual lease can be for a term of up to 50 years, renewable once for a duration not exceeding 50 years. The perpetual lease provides the tenant with extensive rights in terms of the use and development of the leased property, as well as special protection for the tenant (e.g., the tenant's right to cancel the perpetual lease in the event of unforeseeable circumstances or force majeure). A perpetual lease is required to be registered with the cadastral office. Once the perpetual lease is duly registered, a certificate is issued to the tenant as a certification of their lease rights. The tenant may use this certificate to secure any financing required.

The investor may also acquire an economic land concession (ELC), which provides a right to use and develop any specific state-owned land for the development of agroindustrial activities. An ELC is typically granted for 70 years, while the maximum term allowed under the law is 99 years. The maximum land area permitted for a concessionaire is 10,000 hectares. The use of the land is subject to various reporting obligations under the ELC contract and the project's master plan. Therefore, any change of use and activities relating to the land requires approval from the contracting authority, as defined in Sub-decree No. 146 on Economic Land Concessions (2005).

Furthermore, any transfers and disposals of the ELC right are also subject to the terms of the ELC contract (e.g., a transfer of an ELC is possible upon completion of at least 30 per cent of the project) and to the approval of the contracting authority.

The investor is also allowed to acquire the right to use and enjoy any immoveable property though usufruct or an easement.

v Special economic zones (SEZs)

An SEZ is a special area for development of economic sectors, which brings together all industrial and other related activities. SEZs are production areas that may also include a free trade area, service area, residential area and tourist area. As determined by Article 3 of Sub-decree No. 148 on Establishment and Management of Special Economic Zones (2005), an SEZ can only be established in appropriate and strategic areas, as determined by the government and the Council for the Development of Cambodia. To form an SEZ, at least 50 hectares of land within a specific location is required, as well as, *inter* *alia*, geographic boundaries and a surrounding fence (for an export processing zone, a free trade area and premises for investors in each zone). The land area for an SEZ can be freehold or leasehold land.

V REAL ESTATE OWNERSHIP

i Planning

There are no specific laws and regulations regarding the planning of real estate ownership. Zoning is regulated on an *ad hoc* basis according to each municipal and provincial jurisdiction. Certain defined areas in Siem Reap are regulated by the APSARA Authority, which was specifically established to govern Angkor Archaeological Park. Protected areas, where natural resources are considered to be of the utmost importance, are under the jurisdiction of the Ministry of Environment (the MOE).

ii Environment: initial environmental impact assessment (IEIA) and environmental impact assessment (EIA) requirements

Infrastructure projects, whether pre-existing or new, are subject to an IEIA, an EIA, or both. The project owner has to submit an IEIA report with the feasibility study of the project to the MOE for consideration and approval. The MOE may require the project owner to conduct an EIA, depending on the scope of the project and the extent to which the project would cause an environmental impact.

Infrastructure projects that require an IEIA, EIA, or both, include (without limitation) the following:

a all infrastructure projects of all sizes for urban development or in the industrial zones;
b construction of bridges and roads that weigh 30 tons or more;
c buildings with heights of 12 metres or higher, or an area of 8,000 square metres or more;
d restaurants with 500 or more seats;
e hotels with 60 or more rooms; and
f hotels adjacent to coastal areas with 40 or more rooms.

iii Tax

The applicable tax rate is 4 per cent of the market value of the immoveable property for the transfer of ownership or possession rights, or capital contributions into a company in the form of immoveable property. Such tax collection shall be subject to exemption if:

a the ownership or possession rights to the land are in the form of a concession from the government;
b the ownership or possession rights of the immoveable property are recorded in the inventory listings of any institutions in Cambodia; or
c the ownership or possession rights of the immoveable property belongs to diplomatic officials, foreign consular officials, international organisations or technical cooperation agents of the government.

The above rate for tax collection shall also be subject to tax relief in cases of ownership or possession rights of immoveable property belonging to relatives, which shall be subject to tax deductions at the following rates: 200 million riels for succession; and 100 million riels for a donation.

iv Finance and security

Two common security forms of immoveable property include a pledge and a hypothec. The pledge of immoveable property is a form of security whereby the property owner creates a real security interest on the property by delivering the possession or occupation of the property to the creditor as security for any obligations. The pledge term cannot exceed five years, and the renewal period can also not exceed five years, and it must be registered with the cadastral office for full enforceability.

The hypothec, on the other hand, is a form of security whereby the property owner creates a real security interest over the property without delivering the possession or occupation to the creditor to secure any obligations. The perpetual lease, usufruct or concession rights can also be subject to the hypothec security form. The hypothec is created through an agreement between a creditor and the property owner and, like a pledge, it must be registered with the cadastral office for full enforceability.

Under the current regulations and practice, only immoveable property with a hard title certificate can legally be a subject matter of the pledge or hypothec. Therefore, non-registered immoveable properties cannot legally secure any obligation under the pledge or the hypothec.

VI LEASES OF BUSINESS PREMISES

i Types

Two types of lease are available under the Cambodian regulatory framework: a normal lease and a perpetual lease. A normal lease is not required to be registered with the cadastral office to ensure its enforceability. In addition, the lessee may not transfer the lease rights to any third party if the lease agreement does not permit the lessee to do so: this is in accordance with Article 600 of the Civil Code.

A perpetual lease attached to immoveable property, on the other hand, holds for a term of at least 15 years. A perpetual lease constitutes a right *in rem*, which grants to the lessee extensive rights to use and enjoy the property. The perpetual lease is required to be registered with the cadastral office. The term of the perpetual lease cannot exceed 50 years, and can only be renewed once for another term not exceeding 50 years. Through constituting a right *in rem*, the perpetual lease can be, unless otherwise specified by the agreement, assigned or transferred with or without consideration, or alternatively be sublet or the subject of inheritance. Another significant feature of the perpetual lease is that it can be used as collateral for security; it is currently the preferred collateral among banks and financial institutions.

ii Payment term

If there is no specified date for rent payment in the agreement, Article 610 of the Civil Code determines that the payment shall be made at the end of each month in the case of moveable properties and buildings, and at the end of each year in the case of land (or at the end of the harvest season, if applicable). The rent for a perpetual lease, in particular, shall be paid on a specified date as determined by the parties.

iii Termination

The lessor may terminate the perpetual lease in the event that the lessee fails to pay the rental fee for three years. Upon termination of the perpetual lease, unless otherwise agreed by the lessor and lessee, the lessor cannot demand that the lessee restores the leased property to its original condition, unless the lessee was responsible for destroying the property or fundamentally changing its nature. Under Article 254 of the Civil Code, the lessor is entitled to acquire ownership over any improvements and structures installed on the property without having to pay compensation to the lessee, unless agreed otherwise.

iv Renewal

In the case of a lease for immoveable property, the parties shall be deemed to have agreed to renew the terms of such a lease unless a party has declared his or her intention otherwise. This must be decided no later than three months prior to the expiration of the term of the lease, in the case of a building, and no later than one year, in the case of land. These conditions are valid provided that the renewed lease shall be without a fixed term, in accordance with Article 613 of the Civil Code.

VII DEVELOPMENTS IN PRACTICE

i Comprehensive procedures for real right registration

In early 2013, the Ministry of Land Management, Urban Planning and Construction (the MLMUPC) and the Ministry of Justice (the MOJ) issued an inter-ministerial regulation on procedures for registration of real rights pertaining to the Civil Code. The regulation established comprehensive procedures affecting the transfer, change, rectification and termination of land ownership; a perpetual lease; usufruct; privilege; rights on pledge and hypothec; and an easement. This regulation was a long-awaited legal instrument, designed to better implement the Civil Code's provisions regarding any immoveable property and related rights.

As a result of the issuance of such new regulation, there are new formalities and requirements to be complied with regarding the registration of a real right, and the cadastral offices need to change a number of their existing practices accordingly. Currently, it appears that for some relevant officials, a clear and correct understanding of the new rules and procedures is an issue. As a result, consultation or lobbying (or both) with the relevant officials is inevitable, especially for complex transactions such as the multiple registration of real rights for the same property. Furthermore, following the issuance of such new regulation, all previous transactions relating to real rights, such as a usufruct or an easement agreement that are not subject to registration due to the lack of rules or procedures, must be rectified in order to maintain their enforceability.

ii Tentative registration of the management board of co-owned buildings and boreys

According to the laws and regulations, the developer of a co-owned building or a borey must establish a management board for the property that is subject to separate registration with the MLMUPC. At present, the MLMUPC has not established the register for such purpose.

To strengthen the effectiveness of the supervision of co-owned buildings and boreys, in late 2012, the MLMUPC prepared an initial draft circular on the management boards of co-owned buildings and boreys. However, the adoption of the circular is still pending. It is expected that the draft will significantly clarify all important issues affecting the rights and obligations of people involved in co-owned buildings and boreys.

iii New tax compliances affecting real estate transactions

In September 2013, the General Department of Taxation (the GDT) notified the owners of boreys, flats, villas and buildings for sale that they must impose a value added tax (VAT) charge at a rate of 10 per cent on buyers when a property is sold. Such owners must declare a monthly 1 per cent prepayment of tax on profit to the tax administration on the property turnover; otherwise, said owners shall be subject to tax reassessments. In addition, the GDT has suggested that owners can obtain supplies from VAT-registered suppliers in order to receive the VAT input or credit to offset against the VAT output that is imposed on the property sale.

iv New measures affecting economic land concessions

To ensure and strengthen the effectiveness of the management of ELCs, the government issued Order No. 01 (2012), (Order 01) to temporarily suspend the granting of new ELCs (i.e., the ELCs for which the applications had not been approved in principle by the government as of Order 01's issue date). According to Order 01, non-developed or non-performed ELCs will be subject to withdrawal by the government. Furthermore, according to the practice developed under Order 01, the transfer of an ELC by the concessionaire to a third party will also be temporarily prohibited. At present, a transfer can only be made if it is in conformity with the conditions of the ELC contract and at least 30 per cent of the development has already been completed.

Faced with such new measures, concessionaires that need additional technical or financial support, or both, always collaborate with their investment partners (typically foreign investors) to implement their ELC project. The collaborations can be in different forms, such as a joint venture in which interested investment partners implement the ELC project, or a transfer of shares in the concessionaire to potential shareholders, in order to generate capital to continue the investment project.

v Increase in real estate and construction investment

Regarding the real estate sector, at the time of writing, there are 59 licensed real estate companies operating in Cambodia, 33 of which are also members of the Cambodian Valuers and Estate Agents Association. Regarding the construction sector, from 2000 to 2013, 1,298 construction companies were licensed by the MLMUPC. Cambodia has seen a significant increase in the construction sector, both in terms of approved construction projects and investment capital (more than 30 per cent in 2013 compared with 2012), which arguably leads to optimism for 2014.

vi Construction and related compliance, norms and standards

For the past few years, both the public and private sectors have focused on strengthening compliance with the construction norms and standards. On June 2013, the Fire Prevention Law was promulgated. According to this Law, all construction projects shall have proper fire prevention and extinguishing systems in place prior to the commencement of work, and it is the duty of the government to identify the types of projects required to have these systems. At the time of writing, the government has not issued any regulations in respect of this subject.

Furthermore, the public is increasingly focused on safety norms and measures. A recent incident at a garment factory, where the roof of a building collapsed, obliged the factory to pay compensation for civil liability to the relatives of the deceased and to injured workers.

vii Prospective development of the legal framework in the sector

At present, the MLMUPC is finalising the draft amendment to the Sub-decree on construction permits, which is due to be submitted for adoption in early 2014. The MLMUPC is also reviewing and finalising its draft White Paper on land, and a draft on national housing policy; both are set to be completed during 2014. The MLMUPC considers its priorities in 2014 to be the preparation of amendments to the Land Law and to the Law on Land Use Planning, Urbanisation and Construction, the draft of the construction code, and other related laws and their implementing regulations.

VIII OUTLOOK AND CONCLUSIONS

With year-on-year GDP per capita growth rate averaging at 5.6 per cent for the past five years (7.3 per cent in 2012 and 7.6 per cent in 2013), and with the estimated number of tourists reaching the five million mark by 2015, the outlook for the real estate sector is very positive and stable for investors, constructors, developers and operators alike (especially in the capital, Phnom Penh, Siem Reap (the city of temples) and Sihanoukville, which is best known for its beautiful beaches.

With the emergence of the Asean Economic Community in 2015, which is aimed at establishing a single market and production base for economic integration among ASEAN members, Cambodia is an interesting place for real estate investments, including residential, commercial and hospitality properties. Three out of six satellite city projects in Phnom Penh are moving forward slowly, and will generate great interest and significantly boost the real estate industry in Phnom Penh in the next decade.

In future years, the government will focus more on new infrastructural investments, such as international airports, roads, bridges and property development, for both commercial and residential use. These investments are expected to boost the construction sector, as well as increase the investment appetite of foreign investors. Banks and insurance companies will continue to play a significant role in real estate investment and financing, while the influx of foreign investment will further stimulate the entire real estate market.

The agroindustrial sector will also remain a very interesting and strong development area, given that it is one of the government's priorities.

On the legal front, along with recent regulations aimed at promoting the security of real rights, the government will continue to modernise its legal framework, beginning with the construction sector, general investment and the insurance sector.

All of this will undoubtedly have an impact on the real estate market.

Chapter 5

CAYMAN ISLANDS

George Loutas[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

The Cayman Islands has adopted the Torrens Title system of land registration.[2] This system was introduced to obviate the need for a chain of title and the necessity of tracing the vendor's title through a series of documents (to the extent that there is no need to investigate prior dealings affecting property). The fundamental principle of this system of land registration is title by registration (whereby interests in land pass upon registration and not upon execution of any dealing, resulting in the indefeasibility of a registered interest) rather than registration of title.

The main legislation in relation to the registration of interests of land in the Cayman Islands is the Registered Land Law (2004 Revision) (the RLL). Pursuant to the RLL, the title (also known as the register) for each parcel of land in the Cayman Islands is created by a system of land registration (registration), which is maintained by the Registrar of Lands (the Registrar).

Additionally, the register for each parcel of land in the Cayman Islands sets out the proper description and location of the land, the ownership of the land and the identity of any parties claiming an interest in the land by way of security or otherwise. Unregistered or 'overriding' interests (being statutory exceptions to indefeasibility of title) in land are created pursuant to Section 28 of the RLL.

Overriding interests are defined by Section 28 of the RLL as follows:

a rights of way, rights of water and any easement or profit subsisting at the time of the first registration under the Law;

b natural rights of light, air, water and support;

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2 Originally conceived by Sir Robert Torrens in South Australia.

c rights of compulsory acquisition, resumption, entry, search, user or limitation of user conferred by any other law;

d leases or agreements of leases for a term not exceeding two years, and periodic tenancies (in certain exceptions);

e any unpaid monies which, without reference to registration under the Law, are expressly declared by any law to be charged upon the land;

f rights acquired or in the process of being acquired by virtue of any law relating to the limitation of actions or by prescription;

g the rights of a person in actual occupation of land or in receipt of rents and profits save where enquiries made of such person and the rights are not disclosed; and

h electric supply lines, telephone and telegraphic lines or poles, pipelines, aqueducts, canals, weirs and dams erected, constructed or laid in pursuance or by virtue of any power conferred by any law.

No disposition of land (whether by way of transfer, charge or otherwise) is effective unless registered in accordance with the terms of the RLL. Priority of competing interests is determined by the order in which instruments are actually registered.

The government guarantees the correctness of each register. Part X of the RLL provides for the indemnification by the government with moneys provided by the Legislative Assembly (Parliament) in respect of errors or omissions that cannot be rectified by the Registrar or the courts.

Generally, there are no restrictions for individuals or companies purchasing one residential property for personal use and up to two further residential properties for rent. However, if that number is exceeded, this will be deemed as carrying on trade and business in the Cayman Islands, and suitable business licensing will be required.[3]

Ownership of commercial real estate by either an individual or a company will also be deemed as carrying on a trade and business in the Cayman Islands, and suitable business licensing will be required.[4]

If a purchaser wishes to acquire a property in the name of a company, it will need to be purchased in the name of either a Cayman Islands ordinary company (ordinary company), a Cayman Islands branch (foreign company) or a Cayman Islands exempted limited liability company (exempted company) (although an exempted company is an unpopular choice for reasons set out in Section IV, *infra*).[5]

II OVERVIEW OF REAL ESTATE ACTIVITY

There was substantial recovery in the real estate market during 2013, with 2014 looking very promising.

A new government was elected in the Cayman Islands in May 2013. Shortly after that election, the government announced plans to proceed with new cruise ship berthing

3 Sections III and IV of the RLL.

4 Ibid.

5 Section III of the RLL.

facilities in George Town, road infrastructure and a new international airport terminal at Owen Roberts International Airport.

In terms of private sector projects, the first phase of a 2,000-bed hospital facility called Health City Cayman Islands will be opened in February 2014. The complex is also planned to include a medical university and an assisted-care living community. Dart Realty acquired significant real estate holdings during 2013 and is in the process of continued development and expansion of its multi-phased city, Camana Bay. Additionally, Island Heritage Insurance Company acquired the landmark Atlantic Star Building.

The following hotel and tourism developments also took place:

a the construction of a Kimpton Hotel and residences on Seven Mile Beach (which would be the first 10-storey building in the Cayman Islands) is due to commence in 2014;

b a Conrad Hotel and residences in Beach Bay are currently being planned;

c the Ritz-Carlton, Grand Cayman was sold within the past 12 months to New York-based Five Mile Capital;

d the Marriott Grand Cayman Beach Resort and the Westin Grand Cayman Seven Mile Beach Resort and Spa and Exclusive Resorts club were refinanced in 2013;

e the former Hyatt Hotel was stripped down to its core following settlement of a nine-year long insurance claim following Hurricane Ivan; and

f the Embassy Suites Hotel on Seven Mile Beach received approval for an additional two storeys.

Additionally, the announcement by the government during 2013 for work permit term limits being extended from seven years to nine years has led to further activity in the residential real estate market. Coupled with this, the requirements for permanent residency for foreign nationals were amended to require households to increase their real estate investments in the Cayman Islands.

III FOREIGN INVESTMENT

As mentioned in Section I, *supra*, individuals or companies may purchase up to one residential property for personal use and two further residential properties for rent without the need for trade and business licensing.

As also previously mentioned, the ownership of commercial real estate by either an individual or company will be deemed as carrying on trade and business in the Cayman Islands, and suitable business licensing will be required.

The primary legislation dealing with business licensing in the Cayman Islands is the Trade and Business Licensing Law (2007 Revision) (the TBL Law) and the Local Companies Control Law (2007 Revision) (the LCC Law).

Besides the exemptions set out above, an individual or a corporation engaging in almost any business locally is required to be licensed under the TBL Law (TBL licence). The provisions of this Law are mainly administrative. Depending on the nature of the business, certain other approvals may need to be secured in connection with the grant of the TBL licence (e.g., approvals from the Department of Environmental Health or from the Central Planning Authority of the Cayman Islands).

The application procedure for the TBL licence consists of completing the prescribed application form, and providing corporate information and certain other due diligence documents relating to the applicant to the TBL Board together with a cover letter outlining details of the business to be conducted. Currently, a processing fee of US$92 must be paid along with the licence fee as set out in the schedule to the particular law attributed to the business in question (licensing fees currently range between US$183 and US$487,808).

The applicant is able to designate a trading name for the business, which may be different from the name of the applicant. Such name is subject to the approval of the TBL Board.

The TBL licence is renewable annually, and the renewal application form must be submitted 28 days prior to the expiry of the current licence together with the process and renewal fees (which are identical to the fees submitted on the initial application).

For an application to be entertained pursuant to the TBL Law, the applicant, if an individual, must possess Caymanian status or hold a work permit; if a corporation, the applicant must either be beneficially owned or controlled up to at least 60 per cent by persons of Caymanian status, or hold a licence under the LCC Law (LCC licence).

Where an LCC licence is required, the application should be made in conjunction with the TBL licence, as the TBL Board is also responsible for approving the LCC licence.

An LCC licence will not be required where the company falls into one of the following exempted categories (although a TBL licence will normally need to be held in these cases, unless an exemption exists pursuant to law):

a the company has 60 per cent Caymanian shareholders, who maintain 60 per cent of the economic and voting control of the company (the TBL Board must be satisfied that effective control is not, either directly or indirectly, or by reason of any arrangement, artifice or device, invested in, or permitted to pass to, persons who are not Caymanians (e.g., by way of shareholders' agreements, special share classes provided for in constitutional documents)). The TBL Board applies this rule (the 60/40 rule) strictly;

b the applicant has successfully applied to the Governor in Cabinet of the Cayman Islands subject to Section 4(3) of the LCC Law that exceptional circumstances exist (having regard to the public interest) to exempt the applicant from the provisions of the LCC Law (which may be done subject to such terms and conditions as the Governor in Cabinet may deem fit); or

c the applicant falls within one of the exceptions to the meaning of carrying on business as set out in Section 2(2) of the LCC Law, including the following:
- the applicant is carrying on, from a principal place of business in the Cayman Islands, business exterior to the Cayman Islands;
- the applicant is doing business in the Cayman Islands with any person, firm or corporation in furtherance only of the business of that company carried on exterior to the Cayman Islands;
- the applicant is buying or selling or otherwise dealing shares, bonds, debenture stock, obligations, mortgages or other securities issued or created by any exempted company, foreign partnership or a resident corporation incorporated abroad;

- the applicant is transacting banking business in the Cayman Islands with and through a licensed bank;
- the applicant is effecting or concluding contracts in the Cayman Islands and exercising in the Cayman Islands all other powers, so far as may be necessary, for the carrying on of the business of the company exterior to the Cayman Islands;
- the business of an exempted company is with another exempted company, a foreign partnership or a resident corporation incorporated abroad;
- the business is carried on by a mutual fund as defined by the Mutual Funds Law (2013 Revision) in the course of holding common management of an investment, or the acquisition or disposal of an investment;
- the activity is the administration of mutual funds by a person licensed as a mutual fund administrator under the Mutual Funds Law (2013 Revision); or
- the applicant's business is otherwise exempt from requiring an LCC licence.

Companies that are unable to avail themselves of one of the exceptions set out above will require an LCC licence, which, once obtained, will exempt them from complying with the 60/40 rule. An LCC licence enables a company to have more than 40 per cent foreign ownership and control where approved by the TBL Board.

The award of an LCC licence is discretionary, and the following factors, *inter alia*, will be taken into account by the TBL Board when considering an application:

a the economic situation of the Cayman Islands and the due protection of persons already engaged in business in the Cayman Islands;

b the nature and previous conduct of the company and any persons having an interest in that company, whether as directors, shareholders or otherwise;

c the advantage or disadvantage that may result from the company carrying on business in the Cayman Islands;

d the desirability of retaining in the control of Caymanians the economic resources of the Cayman Islands;

e the efforts made by the company to obtain Caymanian participation;[6]

f the number of additional people from outside the Cayman Islands who would be required to reside in the Cayman Islands were the application to be granted;

g whether the company, its directors, and employees have and are likely to continue to have the necessary professional, technical and other knowledge to carry on the business proposed by the company;

h the finances of the company and the economic feasibility of its plans;

i whether the true ownership and control of the company have been satisfactorily established; and

j the environmental and social consequences that would result from the carrying on of the business proposed by the company.

6 The TBL Board requires this condition to be fulfilled by means of public advertising. Such requirement may be waived under various circumstances, and guidelines are provided by the TBL Board on the timing and content of such advertisements.

Foreign investment, if considered beneficial to the Cayman Islands economy, is generally encouraged.

The initial and annual licence fee for an LCC licence is currently US$3,049, plus an initial and annual application and processing fee of US$244. The LCC licence is issued for a duration of no longer than 12 years, and in January of each year, the company will be required to file a return of shareholdings with the TBL Board as at 31 December of the previous year.

An existing foreign corporation wishing to purchase or lease (or otherwise hold an interest in) real estate in the Cayman Islands must be registered at the Cayman Islands Companies Registry as a foreign company; such registration will then enable the corporation to apply for a TBL licence and an LCC licence (if required). Additionally, overseas investors may wish to incorporate an ordinary company and, once incorporated, the ordinary company will be able to own and lease Cayman Islands real estate and apply for a TBL licence and an LCC licence (if required).

IV STRUCTURING THE INVESTMENT

A popular structure for holding real estate is through an ordinary company.

Subject to licensing requirements, this type of company will be able to own and lease Cayman Islands property, hire Cayman Islands-based employees, transact business, both with the public of the Cayman Islands and internationally, and apply for a TBL licence and an LCC licence (subject to the criteria mentioned in Section III, *supra*).

While the fees for establishing an ordinary company are more attractive than for other types of companies, there are additional annual and other requirements that must be met to maintain an ordinary company (e.g., holding an annual general meeting (which may be done by proxy) and filing an annual declaration outlining details of shareholdings with the Registrar of Companies). The annual return must detail, *inter alia*, the names and addresses of shareholders and the number of shares held by them, the amount of the capital of the company and the number of shares into which it is divided, and various details about calls made on shares. An ordinary company is not able to apply for a tax exemption certificate (TEC). An ordinary company is one whose primary purpose is to carry out business in the Cayman Islands, and is therefore the main vehicle that is recommended where the business will entail direct dealings with the public of the Cayman Islands.

Another popular structure for holding real estate is through a foreign company. The foreign company model is particularly useful if a foreign company wants to operate a physical presence in the Cayman Islands directly without setting up a separate legal entity, and it may do so by registering under Part 9 of the Companies Law (2013 Revision).

Subject to satisfying licensing requirements, the foreign company will be able to own and lease Cayman Islands property, hire Cayman Islands-based employees, transact business both with the Cayman Islands public and internationally, and apply for a TBL licence and an LCC licence (subject to the various criteria for these; see Section III, *supra*). When selecting the structure, certain activities of the main company (even where these are not conducted from within the Cayman Islands) could cause the foreign company to be subject to additional licensing requirements under Cayman Islands law.

Examples of businesses where additional licensing may be imposed include banks, trust companies, insurance companies, management companies, mutual funds, mutual fund administrators or entities carrying on securities investment business.

The least popular form of investment vehicle is the Cayman Islands exempted company. This type of company will, in limited circumstances, be able to own or lease Cayman Islands property, hire Cayman Islands-based employees, and transact business internationally (but generally not with the public of the Cayman Islands).

The objects of an exempted company must be carried out mainly outside the Cayman Islands, and it is not permitted to trade in the Cayman Islands with any person, firm or corporation accepting furtherance of the business of the exempted company carried on outside the Cayman Islands. This does not prevent the exempted company from effecting contracts in the Cayman Islands and exercising in the Cayman islands all of its powers necessary for the carrying on of its business outside the Cayman Islands.

As a result, an exempted company structure usually suits a company that wants to own or lease an office to transact business externally from the Cayman Islands. Additionally, an exempted company may apply for a TEC.

V REAL ESTATE OWNERSHIP

i Planning

The following legislation deals with planning control in connection with the development of real estate: the Development and Planning Law (2011 Revision) (the DPL), the Development and Planning Regulations (2006 Revision) and the Development Plan 1997.

The DPL also establishes a central planning authority for Grand Cayman as well as a Development Control Board for Cayman Brac and Little Cayman. These authorities generally review and consider applications to obtain planning permission for development as well as taking enforcement actions (where deemed necessary). Planning permission is required for any development, change or use of land, including carrying out building, engineering or other operations in, on, over or under any land; materially changing the use of any land or the use of any building on the land; and dividing land.

ii Environment

There is no current law in the Cayman Islands dealing with the environment, however, it is generally accepted that the polluter pays.

iii Tax

In addition to registration fees that are payable in connection with the conveyance of real estate, stamp duty is payable on the transfer instrument for each piece of real estate purchased. Pursuant to the Stamp Duty Law (2013 Revision) (the SD Law), stamp duty on a conveyance or transfer of real estate is payable on 7.5 per cent of the consideration. Consideration, for the purposes of the SD Law, is the higher of either the purchase price paid for the property or the market value of the property conveyed or transferred. Further, the market value of any property is the estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing, where the parties have each acted knowledgeably, prudently and without any compulsion.

iv Finance and security

The most common forms of security granted over real estate are as follows:

a legal charges registered over land;
b legal or equitable charges over shares in a company that holds land;
c debentures creating fixed and floating charges over assets held by a company holding land; and
d assignments of rent.

Legal charges over property must be registered on the title for the land at the Cayman Islands Land Registry (Land Registry).

Debentures creating fixed and floating charges are noted on the title for the land at the Land Registry, but are not capable of being registered in their own right.

Charges over shares are recorded on the Register of Shares for the land holding company, and an assignment of rental income is created by way of a deed. Notice of the assignment must be given to the tenant to perfect the securities.

VI LEASES OF BUSINESS PREMISES

Commercial types of leases in the Cayman Islands typically include net leases, gross leases and turnover rent leases.

There are no statutory provisions governing the term length of the lease, rent review mechanisms or renewal right provisions; these commercial terms are governed by contractual arrangements between parties.

Pursuant to the SD Law, stamp duty is assessed on leases on the following bases:

a if the term of the lease does not exceed five years, stamp duty will be equal to five per cent of the average annual rent;
b if the term of the lease exceeds five years but does not exceed 10 years, stamp duty will be equal to 10 per cent of the average annual rent; and
c if the term of the lease exceeds 10 years, stamp duty will be equal to 20 per cent of the average annual rent.

In calculating the length of the term for the purposes of the SD Law, the term will include a right to extend or option to extend that lease. By way of illustration, if a lease is for an original term of five years with a right to extend for a further period of five years and one day, then stamp duty equal to 10 per cent of the average annual rent will be payable.

If the Land Registry deems the average rent is below market value it will assess stamp duty on the basis of the market value. Market value, for the purposes of the SD Law, is the estimated amount for which the property should let on the day of valuation between a willing lessor and a willing lessee on appropriate lease terms in an arm's-length transaction after proper marketing, where the parties have acted knowledgeably, prudently and without compulsion.

In the Cayman Islands, all leases must be stamped, and the obligation to pay stamp duty is with the tenant. In order for any leases to be admitted as evidence in any court hearing, and pursuant to Section 23 of the SD Law, the party propounding that instrument will be required to stamp those instruments.

Pursuant to the RLL, all leases for a term exceeding two years must be registered at the Land Registry.

It is generally in a tenant's interest to have a lease registered, as registration of a lease on title gives 'notice to the world' of its interest in that property. If a lease is unregistered, it is arguable that it does not constitute a legal interest but rather an equitable interest in the property. It is also arguable that a new registered proprietor of property would not be required to take title to that property, subject to an unregistered lease, unless there are existing circumstances where, as a matter of equitable principles, an unregistered tenant is able to argue that it is unconscionable for a purchaser of the property not to recognise that lease. It is likely that mere notice is not enough for that.

In the Cayman Islands, an assignor of a lease is not accountable to the landlord for the assignee from the date of assignment.

VII DEVELOPMENTS IN PRACTICE

During 2013, a proposed bill on new strata legislation was passed for comment by the Law Reform Commission of the Cayman Islands. Discussion on a draft bill commenced in 2010, and much of the impetus was caused by the effect of Hurricane Ivan on Cayman, and the various inadequacies of our current strata law to deal with the insurance, financial and property destruction issues following that natural disaster. (The current strata legislation is based on New South Wales Law from the late 1950s, and is largely outdated.)

Additionally, due to the increasing sophistication of strata developments in the Cayman Islands, a committee was approached to draft a Strata Titles Bill, which has gone through various drafts.[7] The Strata Titles Bill addresses concepts such as tiered, phased and Crown leasehold strata developments. It also updates insurance requirements, winding up and new enforcement mechanisms.

Amendments to the current Strata Titles Law are welcomed on the basis that any of the concepts set out in the draft law are required due to the increased sophistication and volume of strata titled developments in the Cayman Islands.

VIII OUTLOOK AND CONCLUSIONS

2013 was a strong year in terms of investment in real estate in the Cayman Islands, and all indications point to 2014 being very promising in terms of real estate development in the jurisdiction.

7 Maples and Calder has been approached by the Cayman Islands Law Society to lead a review on the Bill.

Chapter 6

CHINA

Alex Wang and Edward Hsu[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

Land in China may not be privately owned, but the usage rights in respect of land (i.e., land use rights) may be privately held for certain periods of time and are generally transferable for a fee. There are two types of land use rights in China – granted land use rights and allocated land use rights.

Granted land use rights confer on the owner the right to use a particular parcel of land for a fixed term – 40 years for certain commercial uses (e.g., hotel, retail and recreational uses); 50 years for certain types of offices, industrial and mixed use projects; and 70 years for residential use. Upon the expiration of the granted term, the usage right and the title to the structures thereon pass to the state without compensation. Prior to the reversion, the holder of the land use right may apply to the government for an extension, which will likely require the payment of an extension fee.[2]

Allocated land use rights are generally held by Chinese state-owned enterprises or other governmental organisations. Foreign investors may hold allocated land use rights for limited types of projects, such as urban infrastructure and power generation projects. The state allocates land use rights for little or no compensation, but retains the right to retake the land from the holders at any time without compensation.[3] Allocated land use rights cannot be transferred, leased or mortgaged, although it is not uncommon to

1 Alex Wang is a partner and Edward Hsu is a counsel at Dentons.

2 Articles 12 and 18 of Tentative Regulations on Land Use Right Grant and Assignment for Land in Urban Areas.

3 Article 23 of the Law on Administration of Urban Real Properties.

do so as a matter of practice.[4] The risk, albeit increasingly remote, of forfeiture without compensation makes allocated land use rights unfavourable for commercial investment.

ii System of registration

China has a well-established system of land registration. When transferring ownership to land use rights or title to building structures, the transacting parties must register the change with the local real estate authority in the jurisdiction where the land is located. In some cities, land and buildings must be registered with different governmental authorities. In other cities, like Shanghai, the real estate authority in the relevant jurisdiction will register transfers of both land and buildings.

The real property register managed by the local registration authority is the primary means of determining title and land-use rights. Once a transfer of land has been registered with the relevant governmental authority, the authority will issue a property ownership certificate. If any of the information set out in the ownership certificate is inconsistent with the information recorded in the real property register, the information in the register will generally prevail.

iii Choice of law

All agreements relating to the development, transfer, lease, mortgage and other forms of disposal of real estate located in China are generally required to be governed by PRC law.[5]

If the real estate in China is held by a foreign-owned entity, a purchase or sale transaction could be structured so that the owner sells its interest in the offshore vehicle that owns the Chinese entity. The documentation for this type of offshore sale structure may be governed by foreign (non-PRC) law.

II OVERVIEW OF REAL ESTATE ACTIVITY

Despite efforts by the Chinese central government to restrain the overheated residential real estate market, the commercial retail, office and logistics sectors have remained relatively strong in 2013.

The retail property market is continuing an upward trajectory, with high-end international department stores such as Galleries Lafayette and Lane Crawford opening flagship stores in Beijing and Shanghai, respectively.

In addition, rentals for prime office space have held steady in 2013. Average occupancy costs in the Beijing financial district have now shot to the third-highest in the world at US$195.07 per square foot per year, well ahead of that of Tokyo (Marunouchi/Otemachi), London (Central), and New York (Midtown Manhattan).[6]

4 Article 5 of Tentative Measures for Administration of Allocated Land Use Rights.

5 Article 36 of the Law on Choice of Law for Foreign-related Civil Relationships.

6 Based on the Prime Office Occupancy Costs Survey released by CBRE Global Research and Consulting in July 2012.

Offshore financing for Chinese real estate investments remains strictly prohibited (except for offshore ownership structures that existed prior to 2007); however, some offshore financial institutions have developed a greater risk appetite for mezzanine-type loan products that are enabling property players to secure funding for real estate acquisitions in the mainland. Onshore renminbi financing remains relatively restricted by governmental controls on liquidity.

Domestic real estate developers and investors are also making plays in niche areas such as affordable housing and senior care facilities. These types of projects are generally encouraged by regulators given their socioeconomic benefits. The government has publicly set a goal to facilitate the construction of 36 million affordable housing units (i.e., low-income housing) between 2011 and 2015. To help realise this goal, the government has released a series of policies to open funding channels and encourage investments.

III FOREIGN INVESTMENT

i Common issues relating to PRC real estate investments

Financing

Foreign debt and foreign currency exchange

China's foreign exchange regulations require domestic enterprises and foreign-invested enterprises (FIEs) to register with a local branch of the State Administration of Foreign Exchange (SAFE) all foreign currency loans or debt borrowed from non-PRC residents or entities. Failure to register will result in unenforceability of the loan agreement and an inability to subsequently convert or remit the principal and interest to the offshore lender.[7]

Following the release of Circular 130 in July 2007,[8] SAFE will not process any foreign currency loan, register debt or settle foreign exchange loans for foreign-invested real estate enterprises (FIREEs) that were approved by or filed with the Ministry of Commerce (MOFCOM) on or after 1 June 2007. As such, offshore parent companies and investors have not been permitted to extend shareholder loans or inter-company loans to a FIREE since 1 June 2007. Circular 130 is thus a critical barrier to financing foreign-invested real estate companies in China, as it effectively closes off foreign financing, thereby leaving injections of registered capital as the main source of offshore funding for such entities (unless there were existing shareholder loans in place prior to Circular 130).

Domestic debt

Historically, renminbi borrowings by FIREEs were generally not considered debt in determining compliance with the debt-to-equity ratio limitations mentioned above. This is because renminbi financings by domestic banks were not required to be registered

7 Articles 38 and 40 of Tentative Measures for Administration of Foreign Debts.

8 Circular on Issuance of List of First Group of Foreign-invested Real Estate Companies Filed with Ministry of Commerce.

with the government. Consequently, domestic banks were relatively more flexible than their foreign counterparts in extending credit to FIREEs. However, due to regulatory tightening of liquidity, there appears to be an increasing trend among local banks to include renminbi loans in their calculation of the debt-to-equity ratio of FIREEs.

Domestic banks and FIREEs are also subject to other legal requirements and internal policies, including the following:

a For renminbi-denominated construction loans, the proposed drawdown amount with respect to a utilisation of the loan may not exceed the capital expenses actually incurred by the borrower since the previous drawdown.[9]

b Domestic Chinese banks may not lend to a FIREE unless the bank has determined that the FIREE has paid its minimum registered capital; obtained a valid land use right certificate and planning permit, and the construction permit for the relevant real estate project; and contributed no less than 35 per cent of the total capital requirements of the development project.[10]

Repatriation

Due to regulatory restrictions and the limited convertibility of the renminbi, repatriation techniques common in other jurisdictions are problematic in China. As a consequence, cash repatriation is a key issue for foreign investors in the Chinese real estate market. Set forth below are some potential avenues for repatriating cash.

Dividend distributions

Dividend distributions are the most straightforward way to repatriate cash. The domestic rate of withholding tax on dividends is currently 10 per cent,[11] and may be reduced up to 5 per cent under certain tax treaties. The effectiveness of dividend distributions as a method of repatriation is limited for several reasons: dividends may usually only be declared once per year; real estate projects typically lack dividend paying capacity (i.e., insufficient after-tax accounting retained earnings, depreciation and other non-cash charges reduce accounting profits); and there may be certain statutorily prescribed equity reserve amounts that must be funded from otherwise distributable retained earnings.

Repayment of shareholder loans

Following Circular 171,[12] SAFE will not register any foreign loans extended to onshore entities. This, however, does not retroactively apply to third-party loans or shareholder loans that were made prior to Circular 171 and that were registered with SAFE. Payment

9 Article 29 of Tentative Measures for Administration of Fixed Asset Loans.

10 See Opinions Governing the Market Access and Administration of Foreign Investment in Chinese Real Estate Market issued by the Ministry of Construction, MOFCOM, SAFE, the National Development and Reform Commission, the People's Bank of China and the Administration of Industry and Commerce on 11 July 2006.

11 Article 91 of the Implementing Regulations of the Enterprise Income Tax Law.

12 See footnote 10.

of principal and interest on these 'grandfathered' loans is generally considered the most direct way to repatriate funds offshore.

Reduction of capital contribution

Another means of repatriating cash is for the offshore holding company to reduce, or require its local partners to buy back, a portion or all of its capital contributions in the onshore project company. This share redemption approach, however, is often difficult to achieve in practice because government authorities strictly scrutinise such transactions. Similarly, while the buy-back arrangement is legally permissible, it typically requires more complicated legal documentation and may result in additional PRC tax liabilities.

Consulting and service agreements

Another avenue to repatriate cash that is trapped onshore is pursuant to a pre-existing consulting services agreement. Under this approach, the onshore project company enters into a consulting services or management agreement with an offshore affiliate that acts as the project manager or asset manager. Under this arrangement, the trapped cash may be remitted offshore to the asset manager in the form of a consulting or asset management fee. This fee is subject to SAFE approval. SAFE authorises the banks to review foreign exchange payments under trade in goods or services. The bank typically checks the service agreement, commercial invoice and tax payment certificate, together with other relevant documents, and will make the payment on the same working day upon submission of all the required documents.

IV STRUCTURING THE INVESTMENT

i Structuring a PRC real estate investment

Selecting the onshore project entity

Foreign investors may generally only invest in, develop, operate or hold commercial real estate in China through an FIE established pursuant to the PRC foreign investment law. The FIE is typically structured as a wholly foreign-owned enterprise (WFOE) or a Sino-foreign equity joint venture (EJV). Selection of the appropriate entity will depend upon the investor's market entry strategies and business needs.

WFOE

A WFOE is an entity that is owned entirely by one or more foreign investors.[13] Its owners have full control of the entity and any real estate it owns. Under current regulations, there are certain limitations on using a WFOE in real estate projects – for example, WFOEs may not be used to develop a block parcel of land.[14]

13 See the Law on Foreign Invested Enterprises.

14 See the Catalogue of Industries for Guiding Foreign Investment.

EJV

An EJV is a limited liability Chinese entity established by one or more Chinese investors and one or more foreign investors. Investors in an EJV are required to share profits and losses strictly in proportion to their respective equity interests. EJVs resemble Western-style corporations in many respects, but differ in certain fundamental areas: investors hold equity interests instead of stock, EJVs generally have a limited duration,[15] and any transfer of an owner's equity interest requires prior approval from the government and would be subject to a right of first refusal by all of the other investors in the EJV.[16]

Forming an FIREE

The formation of an FIREE requires approval from various government agencies. Specific procedures regarding the establishment of an FIREE often vary between local jurisdictions and will depend on the business scope of the FIREE. The following is a general summary of the requisite approvals and other necessary registrations and filings.

Name pre-registration with the State Administration for Industry and Commerce (SAIC)

The first step in forming a FIREE is for the foreign investor to register the proposed name of the FIREE with SAIC.[17] SAIC will generally issue a confirmation within five working days indicating whether the name is available (i.e., that there is not a similar company that uses the same name in the same industry).

Examination and approval by MOFCOM at the local, provincial and national levels

The foreign investor must then submit an application to the local branch of MOFCOM, together with the FIREE's proposed joint venture agreement (in the case of an EJV), its articles of association, a feasibility study report (a detailed description of the FIREE's proposed business) and other documents. A decision is usually rendered by the local branch of MOFCOM within a period of 30 to 60 working days after MOFCOM determines that the foreign investor has submitted a complete set of application documents.

Following receipt of approval by the local branch of MOFCOM, the local branch will make a filing with the provincial branch of MOFCOM, which reviews the decision of the local MOFCOM. If approved, the provincial branch of MOFCOM will normally issue an approval certificate within 30 working days after filing by the local MOFCOM branch.[18] The highest MOFCOM authority, the national MOFCOM, will conduct spot checks on the work performed by the provincial MOFCOM from time to time.

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15 The duration for EJVs is limited to 50 years. The typical permitted duration for manufacturing EJVs is 30 to 50 years, and 10 years for real estate EJVs due to the project cycle. EJVs may apply for an extension of the duration six months prior to the original expiration date.

16 See the Law on Equity Joint Ventures.

17 Article 17 of the Regulations on Administration of Company Registration.

18 See the Notice on Doing a Good Job in Archival Filing of Foreign Investment in the Real Estate Industry issued by MOFCOM on 18 June 2008.

Registration with SAIC

Within 30 days of the issuance of the approval certificate, the foreign investor must apply to SAIC to officially register the company and to obtain a business licence. SAIC typically issues the FIREE's business licence within 30 working days.

Other registrations and approvals

Within 30 days of the issuance of the business licence, the FIREE must complete various registration formalities. Additional registrations and approvals are necessary in connection with construction activity. The entire process to establish a FIREE, from pre-registration of the proposed name of the FIREE to the final registrations, generally takes between three to six months to complete.

Minimum capital requirements

The formation documents of a FIREE must set forth its total investment amount, a portion of which must be contributed as registered capital (i.e., minimum equity). The ratio between the registered capital and the total investment should generally follow the following principles:[19]

Total investment	*Minimum registered capital*
US$3 million or less	At least 70 per cent of the total investment
Over US$3 million and up to and including US$10 million	The greater of 50 per cent of the total investment or US$2.1 million
Over US$10 million	At least 50 per cent of the total investment

The difference between the total investment amount and the registered capital may, subject to certain restrictions, be funded through third-party bank financings or shareholder loans.

A FIREE's registered capital is generally not permitted to be transferred outside the PRC unless the FIREE has obtained approval for dissolution or for a reduction of its registered capital. In general, it takes six months or longer for a FIREE to obtain all required approvals for dissolution and to complete the liquidation procedures.

V REAL ESTATE OWNERSHIP

i Planning

To change the land use of a parcel of land, the owner must submit an application to and negotiate with the local planning authority.[20] Subject to the urban or city overall development plan, the local planning authority has discretion to approve the change

19 These ratios were set forth in the Regulations on the Ratio between Total Investment and Registered Capital for Equity Joint Ventures issued by the General Office of the State Council on 5 September 1985, which was abolished but is still referred to by certain approval authorities in practice.

20 Article 23 of the Implementing Regulations for the Law on Administration of Land.

of usage after internal discussions with the local land and resources bureau and other government authorities. If approved, the owners are generally required to pay an additional land premium to the local land and resources authorities.

ii Environment

In respect of environmental liability, the general rule under PRC tort law is that the polluter pays. Under the Law on Prevention of Solid Waste Environmental Pollution, a company that has violated environmental laws may be subject to administrative penalties, such as fines, confiscation of illegal proceeds, and costs required to treat or restore contaminated land. In severe cases, a company may be ordered to suspend or close down operations.[21]

The Chinese Ministry of Environmental Protection recently mandated nationwide compulsory purchase of pollution liability insurance for companies with high environmental risks, ahead of the originally forecasted target date of 2015.[22]

iii Tax

Transfer taxes

Taxes and fees in relation to an asset sale or disposition

Sales of real property are subject to taxes and fees based on the transfer price and the profit with respect to a sale or disposition. These taxes apply to transfers to related parties (including subsidiaries). The tax authorities have discretion to adjust the amount of taxes due upon determination that the transfer was priced below market value.

Enterprise income tax (EIT)

If the seller is a Chinese project company, it is subject to EIT of 25 per cent on its capital gain.[23]

Business tax

The seller must pay business tax at a rate of 5 per cent on the net proceeds of the sale. A seller may deduct the original purchase price paid for the land from the gross proceeds amount in calculating the applicable tax basis, provided that no improvements were made on the land after the seller originally purchased the property.[24]

Land appreciation tax (LAT)

The seller must also pay LAT on the net gain resulting from the transfer of real property. The progressive LAT rates range from 30 per cent to 60 per cent of the net gain from the sale. Net gain is equal to the sales proceeds minus the cost of the property, which includes

21 Article 83 of the Law on Prevention of Solid Waste Environmental Pollution.

22 See the Guiding Opinion on the Pilot Program for Compulsory Environmental Pollution Liability Insurance issued by the Ministry of Environmental Protection and the China Insurance Regulatory Commission on 21 February 2013.

23 Article 4 of the Enterprise Income Tax Law.

24 Articles 2 and 4 of the Tentative Regulations on Business Tax.

the land premium paid, the cost of the improvements and other taxes on the transfer of the real property.[25]

Deed tax

Purchasers of real property must pay a deed tax of 3 per cent to 5 per cent (depending on jurisdiction) on the total transfer value.[26]

Stamp duty

The seller and purchaser are each responsible for paying stamp duty at a rate of 0.05 per cent of the contract value.[27]

To attract investment, some local governments will agree to return a portion of these taxes (usually the business tax) or offer financial subsidies to a developer or real estate company, or otherwise reduce the tax rate applicable to a transfer, or both.

Taxes in relation to the transfer of equity interests

In contrast to an asset sale, the sale of an equity interest usually will not trigger any tax liability for either party other than the payment of stamp duty. If the equity in an offshore entity is transferred, there may not be any China taxes at all, provided that the holding company is not deemed to be resident in China for tax purposes, and the transaction structure is not considered to have been used primarily to evade Chinese tax liability.

Circular 698 and Anti-Avoidance Rules

Under Circular 698, tax authorities may in certain circumstances disregard the existence of an offshore intermediate holding company (an indirect disposal) and tax the sale of shares in such a company as if it were a direct disposal of shares in the underlying Chinese company. In the context of an indirect disposal, Circular 698 requires a controlling shareholder to report any sale in the shares of an offshore intermediate holding company that owns shares in a Chinese company, provided that one of the following conditions is met:

a the combined tax rate applicable to capital gains derived from the share transfer in the jurisdiction of the offshore intermediate holding company whose shares are being transferred is less than 12.5 per cent; or

b the jurisdiction in which the offshore intermediate holding company is resident provides an income tax exemption for foreign-sourced income.

The deadline for reporting such a transfer to the tax authorities is 30 days after the execution of the share transfer agreement. Foreign investors who use or have used offshore holding companies to invest in Chinese real estate should pay particular attention to the retroactive effect of Circular 698.

25 See the Tentative Regulations on Land Appreciation Tax.

26 Article 3 of the Tentative Regulations on Deed Tax.

27 Article 3 of the Tentative Regulations on Stamp Duty.

The non-resident seller of the offshore holding company is required to submit to the PRC tax authorities detailed documentation regarding the equity transfer, as well as information regarding the operations of the offshore holding company, the relationship between the vendor, the offshore holding company and the PRC resident enterprise, the business purposes behind the structure and other materials requested by the tax authorities. This information will be used by the tax authorities to examine the substance of the transaction and determine whether it has been undertaken for tax-avoidance purposes.

iv Finance and security

The most common form of security granted over real estate is a real property mortgage. Under PRC law, a property mortgage is defined to be a non-possessory type of security: the debtor or a third party uses property to secure a debt without the transfer of possession to the mortgagee.

The types of property that may be mortgaged include the following:

a structures and other attachments to land;
b land use rights;
c management rights with respect to land;
d production equipment, raw materials, semi-finished products and products;
e buildings, vessels and aircraft under construction;
f means of transport; and
g other property, the mortgage of which is not prohibited by law or administrative regulation.

In general, to effect a mortgage over real property, the mortgagor and mortgagee must enter into a written mortgage agreement and register the mortgage agreement with the local real estate authority within 30 days after the execution of the mortgage agreement.[28] A mortgage over real properties is created and effective against third parties at the time the mortgage is registered with the relevant real estate authority.

VI LEASES OF BUSINESS PREMISES

The following is a summary of the basic lease terms for commercial leases in China.

i Term

Under PRC law, the maximum term of a lease is 20 years. The term of an office or retail lease is generally three to five years.

ii Property management services and management fees

In commercial leases, the landlord will provide, or engage a third-party property manager to provide, the tenant with property management services. Instead of being required to pay its *pro rata* share of operating expenses directly, the tenant is normally charged a

28 Article 30 of the Measures for Administration of Mortgage of Urban Real Properties.

fixed monthly management fee (calculated on a square metre basis). The management fee is generally determined by the landlord after taking actual operating expenses into consideration.

iii Self-help

China does not have a clear eviction or summary judgment process with respect to defaulting tenants. The current market practice is for the landlord to include lease provisions that permit it to cut off the utilities to the leased premises in the event of a major uncured default by the tenant.

iv Right to first refusal

PRC law provides tenants with a statutory right of first refusal with respect to sale of the leased premises (ROFR). If the tenant waives the ROFR and the landlord transfers the leased premises to a third party, the tenant and the third-party purchaser will be bound by the lease contract until the expiration of the lease term.

v Priority over the mortgagee's claim

If a mortgage is created over the leased premises after a lease is signed, a tenant will have a priority over the mortgagee's claim in the event of a foreclosure of the property. The mortgagee or third-party purchaser of the foreclosed property must honour the lease until the expiration of the original lease term expires. Conversely, if a mortgage is created over the leased premises before a lease is signed, the tenant will not enjoy any rights in connection with the foreclosure of the property. Under these circumstances, the new owner may terminate the lease and evict the tenant as soon as it receives title to the property.

VII DEVELOPMENTS IN PRACTICE

A major continuing development in China's real estate sector is the government's effort to cool down the real estate market. The central government policies that have been implemented over the past three years (which include limiting the number of residential properties that each household may purchase, raising the down payment requirements (from 20 per cent to 30 per cent on first homes and from 40 per cent to 60 per cent on second homes),[29] enforcing taxation of property sale proceeds and restricting the availability of mortgages) have had an overall dampening effect on the residential real estate market. However, given the large demand for residential housing, a paucity of

29 See the Circular on Determined Suppression of the Exceedingly Rapid Rise of Urban Housing Prices in Certain Cities issued by the State Council on 17 April 2010; the Circular on Issues Concerning Improving Differentiated Housing Loan Policies issued by the People's Bank of China and the China Banking Regulatory Commission on 29 September 2010; and the Circular on Issues Regarding the Further Regulation and Control of the Real Estate Market issued by the General Office of the State Council on 26 January 2011.

quality investment options and local government support for real estate transactions, many believe that growth in the residential sector will remain steady for the foreseeable future.

Another key development is the unveiling of China's first free trade zone, which opened in Shanghai in September 2013. The free trade zone is the latest step in a national strategy to further open up markets and make Shanghai an international trade and finance hub. Although details regarding the regulatory parameters of the zone are yet to be released, initial guidelines promise to liberalise some important industry sectors, including financial, shipping, commercial and professional services. It is also anticipated that the zone will support the development of an offshore financial centre and free convertibility and exchange of the renminbi. Thus far, no details have been released relating to the ownership or transfer of real estate within the free trade zone.

VIII OUTLOOK AND CONCLUSIONS

2013 has been a year of important political changes in China. Over the past 12 months, the country has witnessed a successful transition in the top leadership of the central party and a series of government measures aimed at reigning in a perceived real estate bubble. In response to new government policies aimed at the residential real estate market, many developers and investors have begun shifting their business strategy, and have refocused their project pipeline away from the residential sector and into commercial, retail and logistics assets.

One of the biggest changes in 2013, however, is not with regard to investment in Chinese real estate, but the astonishing level of investment dollars that the Chinese are using to buy and develop real estate abroad. By all accounts, this outbound investment trend will continue for many years to come. In November 2013, two major Chinese investors agreed to funnel nearly US$4 billion into real estate deals in New York City (Greenland Holdings agreed to pay over US$3 billion for a majority stake in a large development project in Brooklyn, and Fosun Group won the bid for the office tower at 1 Chase Manhattan Plaza for US$725 million).

Chapter 7

CYPRUS

Nicolas Papaconstantinou[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

Cyprus is a business-friendly country with a strong economy. In 2004, Cyprus became a member of the European Union, and in 2008 joined the eurozone.

The location of Cyprus, its reliable legal system and the developed infrastructure are some of the advantages that Cyprus has to offer to foreign investors. Furthermore, the recent adoption of the euro has made the trading of land significantly easier than before.

The country's legal system is closely related to that of the United Kingdom. Most statutes regulating business issues and practices are based on English common law. Cyprus has developed an excellent legal system for real estate that is on a level with the systems of other economically advanced countries.

i Ownership of real estate

There are three types of ownership in Cyprus: freehold, leasehold and shared ownership.

Freehold is the most common manner by which real estate is owned in Cyprus; it is an estate in fee simple absolute. Freehold offers the owner of that interest the exclusive right to the land for an indefinite period of time. This is usually the most complete ownership of interest that may be owned in real estate property. Even in freehold, however, land ownership rights may be limited, by legislation, by contract or by tenure.

Leasehold is an interest for a specific term of years that is absolute; in this case, one party purchases the right to occupy land for a specific duration of time.

Under Cyprus law, any leaseholds with an unexpired term of 15 years or more may be registered at the Department of Land and Surveys; however, the registration of a lease agreement must comply with certain conditions and requirements that are provided

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in the law. Such registration would entitle the lessees to sell, mortgage, transfer or pass on the leasehold to their heirs.

Shared ownership is the ownership of real estate, in undivided shares, by more than one person.

ii System of registration

Cyprus uses a system known as the registration of title to land; this system safeguards the rights of the owners of an immoveable property and at the same time provides security for the immoveable properties transactions.

This system of registration is under the control of the state; its subject matter is the parcel of land shown on cadastral plans that are linked to each other and covers the entire country. All lands, both state-owned as well as privately owned, appear on the register. Land registration is exercised by the Department of Lands and Surveys of Cyprus under the Ministry of the Interior, which is considered to be the oldest department of the public sector (its operation commenced in 1858).

The advantage of registration lies between an indefeasible title and a defeasible title. In other words, registration renders the registered person as indefeasible owner of the land and gives it absolute title; however, this absolute title is subject to both the inherent power of the courts to order an amendment, and also to the Lands and Surveys Department directors' powers to rectify mistakes or omissions.

All transfers or charges of immoveable properties must be registered with the District Office of the Department of Lands and Surveys to have legal effect.

The title is not covered by a state guarantee and there is no provision for an indemnity fund; however, the Cyprus system of registration is highly respected and trusted among the public.

iii Choice of law

There is an abundance of laws in Cyprus that apply to transactions involving real estate. These laws fall into two broad categories: general and specialised.

General laws

Despite the fact that they do not directly control issues related to real estate, the laws in this category include provisions that apply to transactions concerning real estate. These include:

a the Administration of Estates Law, Cap. 189;
b the Central Bank of Cyprus Law, No. 138(I)/2002;
c the Civil Procedure Law, Cap. 6, and Rules;
d the Constitution of Cyprus;
e the Contract Law, Cap. 149;
f the International Trusts Law No. 69/1992;
g the Movement of Capital Law, No. 115(I)/2003;
h the Probates (Re-Sealing) Law, Cap. 192;
i the Stamp Law, No. 19/1963;
j the Trustee Law, Cap. 193; and
k the Wills and Succession Law, Cap. 195.

Specialised laws
These are laws that are introduced specifically for regulating real estate issues. This category includes:
a the Acquisition of Immoveable Property (Aliens) Law, Cap. 109;
b the Capital Gains Tax Law, No. 52/1980;
c the Compulsory Acquisition of Property Law No. 15/1962;
d the Immoveable Property (Tenure, Registration & Valuation) Law, Cap. 224;
e the Immoveable Property (Towns) Tax Law, No. 89/1962;
f the Immoveable Property (Transfer and Mortgage) Law, No. 9/1965;
g the Immoveable Property Tax Law, Cap. 322;
h the Rent Control Law, No. 23/1983;
i the Streets and Building Regulations Law, Cap. 96;
j the Sale of Immoveable Property (Specific Performance) No. 81(I)/2011; and
k the Town and Country Planning Law No. 90/1972.

II OVERVIEW OF REAL ESTATE ACTIVITY

In 2012, Cyprus became the fifth eurozone country to seek an international bailout after its banks were battered by their exposure to the Greek crisis. Cyprus and its international lenders (the European Commission, the European Central Bank and the IMF (together, the troika) agreed in March 2013 on a €10 billion bailout programme, which provided for a haircut on uninsured deposits in the island's two largest banks. The bailout was coupled with strict capital controls, which as time passes are being partially relaxed.

Up to 2008, Cyprus enjoyed a housing boom that had lasted for a decade, but since then the property market has declined; the main reasons for this downward trend have been the international economic crisis and the decrease in demand from British buyers, who used to constitute more than half of foreign buyers in Cyprus. Delays in obtaining title deeds combined with the fall in value of sterling against the euro, as well as the UK recession, drove British buyers to look for investments outside Cyprus and the eurozone.

A further problem for the real estate market is the limited availability of finance. Cyprus's two main banks suffered heavy losses from a write-down of Greek sovereign debt, which was supported by all EU member states, including Cyprus. The above-mentioned assistance package agreed with the troika featured a haircut on uninsured deposits to recapitalise the Bank of Cyprus, whereas Cyprus Popular Bank was wound down. It is anticipated, however, that the recapitalisation from the bailout agreement with the troika will allow the banks to start providing loans to potential purchasers again.

The prices of residential properties have decreased, in certain circumstances up to 30 per cent[2] in the past four years, with those areas popular among foreign buyers, such as Paphos, being most affected. Areas that rely mainly on local buyers, such as Nicosia and Limassol, have recorded significantly smaller drops.

2 There are as yet no long-standing property price statistics in Cyprus; the Royal Institution of Chartered Surveyors released its first Property Price Index for Cyprus in January 2010.

With the finalisation of the bailout package, sterling showing signs of recovery against the euro and the government's measures to speed up the process of issuing title deeds, there outlook on future demand for properties is positive.

The most important and far-reaching recent development has been the discovery of oil and natural gas off the southern coast of Cyprus, which creates major opportunities for the recovery and growth of the Cyprus economy and, of course, the property market.

In late 2011, Noble Energy, operating Block 12 of the island's exclusive economic zone (Noble holds a 70 per cent working interest in Block 12, while Delek Drilling Limited Partnership and Avner Oil Exploration Limited Partnership each individually hold a 15 per cent share), announced an offshore discovery with estimated gross mean resources of 5 trillion cubic feet (tcf), a quantity of natural gas that, according to officials, could be enough to meet Cyprus's gas needs for the next two centuries. In October 2013, Noble confirmed its estimate to within a range of 3.6tcf to 6tcf, with a mean of approximately 5tcf.

On 11 February 2012, the EU's Official Journal published the Cyprus government's announcement of the launch of the second licensing round for offshore oil and gas exploratory drilling in the remainder of Cyprus's delineated economic zone. In January 2013, the consortium of ENI (Italy) and Kogas (South Korea) signed exploration and production-sharing contracts with the government for Blocks 2, 3 and 9, which encompass an area of around 12,530 square kilometres. French Total SA has also been awarded production-sharing contracts for Blocks 10 and 11, which total 2,572 square kilometres. ENI-Kogas is expected to commence exploration activities in the third quarter of 2014, while Total is expected to begin offshore drilling in the first quarter of 2015.

III FOREIGN INVESTMENT

The ownership of real estate by overseas investors in Cyprus is regulated by the Immoveable Property Acquisition (Aliens) Law, Cap. 109. On 16 December 2011, this Law was amended so that the restrictions concerning the acquisition of secondary residence by nationals of EU Member States were no longer applicable.

Under the new provisions, EU and EEA nationals, as well as legal entities incorporated under the laws of any EU or EEA Member State that have their registered office, central management or principal office in an EU or EEA Member State, will not fall within the definition of an alien. This means that they need not apply for permission from the Council of Ministers to purchase immoveable property in Cyprus. With regard to non-EU nationals, however, the previous restrictions still apply.

Under the law, no alien (non-EU national) may acquire immoveable property in Cyprus, other than by reason of death, without the prior permission of the Council of Ministers, a power that has been delegated to the district officer of each district. The approval procedure takes between three and six months; however, purchasers are entitled to occupy the property in the meantime.

Such permission is required for both the purchase of immoveable property as well as for leases exceeding 33 years. Normally, such permission is granted *bona fide* to alien individuals to purchase one apartment, one house, or a building plot or land up to 4,014 square metres in size.

It is at the discretion of the Council of Ministers (now the district officer) to grant permission to foreign nationals to acquire a larger piece of property if the land is to be used for specific purposes such as tourist development, or if the land is in an area where the government wishes to encourage the tourist infrastructure.

The government, in its effort to attract foreign investments, has recently introduced policies allowing full-residency permits through investment. The Category F visa permit applies to third-country nationals who will not be working in Cyprus but will stay in Cyprus as permanent residents. The main prerequisites for applying for the above permanent permit are to have a certain level of secured annual income and to have purchased a residence for self-occupancy in Cyprus worth at least €300,000.

Further, third-country nationals can even obtain Cyprus citizenship and a passport by exemption, based on their investments and financial affairs in Cyprus. More specifically, during a meeting on 25 May 2013, the Council of Ministers decided to implement a policy of economic citizenship by which fast-track citizenship will be granted to non-Cypriots who satisfy criteria based on a combination of investments, donation to a government fund, business activities and deposits in Cypriot banks. One possible investment requirement to constitute an eligible application is direct investment in real estate of at least €5 million.

IV STRUCTURING THE INVESTMENT

Cyprus enjoys one of the lowest corporate tax rates in the EU, which is 12.5 per cent. Therefore, instead of purchasing real estate in the name of a physical person, a typical investment structure from a tax point of view is to form a limited liability company in Cyprus and purchase the immoveable property in the company's name; the tax payable by the Cypriot company is then calculated upon the net profit earned at a rate of 12.5 per cent.

With regard to rental income produced, there is an allowance of interest paid, as well as a 3 per cent wear-and-tear allowance in addition to any other expenses. Further, if the company issues dividends to shareholders not residing in Cyprus, the whole amount of the dividend is exempt from tax. For shareholders who are residents in Cyprus, however, there is a special defence tax payable at a rate of 20 per cent on the dividend received.

Another advantage is that a company that owns real estate can transfer its shares into the name of the purchaser instead of transferring the real estate itself. In this way, no transfer fees are payable, but there will be capital gains tax payable on the profit made by selling the shares.

V REAL ESTATE OWNERSHIP

i Planning

The Department of Town Planning and Housing, which is a government department under the Ministry of Interior, is responsible for planning control in Cyprus. The main purpose of the Department is to regulate urban and spatial planning under the provisions of the Town and Country Planning Law of 1972.

Cyprus is divided into different planning zones such as residential, agricultural, green belt, industrial, animal rearing and tourist. The construction of houses is constrained or forbidden in certain zones. The planning zone determines the building coefficient, the nature of use that is permitted, the number of storeys allowed and the site coverage.

Before purchasing land in Cyprus, it is essential to visit the actual site and seek expert advice to determine its characteristics and its planning restrictions.

ii Environment

Under the Law of Control of Water Pollution 106/2002 as amended, the contamination of underwater or soil constitutes a criminal offence. The Law expressly prohibits the following:

a disposal or distribution into a stream, dry river bed of any stream, coastal waters, lake or dam of any type of object or substance that pollutes or tends to pollute their water;

b disposal or distribution on the soil or subsoil of any object or matter in a way that pollutes or tends to pollute coastal waters or underground waters, stream water or the water of a lake or dam;

c the placement of any object or matter in a position from where it is probable that it will drop or be transmitted into a stream, lake or dam in a way that would pollute or tend to pollute their waters;

d disposal or allowing the disposal of any liquid waste, mud, or other semi-liquid or solid waste from any kind of installation that is on or in the ground or underground;

e disposal, placing or allowing the disposal from any installation into any waters over the ground or coastal waters, of any liquid or solid waste, or any other liquid enclosing floating substance; and

f disposal, placing or allowing the disposal of mud into the sea or any other substances that arise from waste treatment.

The law provides that persons found guilty of any of the above offences will be liable to a maximum sentence of three years' imprisonment or a maximum fine of €85,430, or both.

iii Tax

Value added tax (VAT)

In Cyprus, VAT is imposed on newly built properties whose town planning permits were submitted after 1 May 2004. For properties built after that date, VAT is charged at 18 per cent; however, Parliament recently enacted legislation whereby the standard rate of VAT has been increased to 19 per cent, effective from 13 January 2014.

To enhance the housing market, on 1 October 2011, new legislation came into force that enables property purchasers under certain circumstances to pay as little as 5 per cent VAT on their property purchase, provided that the purchaser will use the property for his or her own residential purposes.

Transfer fees

Transfer fees are levied upon the transfer and registration of the property in the name of the purchaser. The transfer fees are payable by the purchaser to the Department of Land and Surveys. The amount payable is based on the market value of the property at the time of purchase as determined by the Department of Land and Surveys (usually the same as the purchase price).

Transfer fees are calculated according to the following rates:

a up to €85,430: 3 per cent;
b €85,430 to €170,860: 5 per cent; and
c above €170,860: 8 per cent.

To stimulate the sale of new property, Parliament has voted to abolish or reduce the transfer fees. The changes came into effect on 2 December 2011 for a period of six months, and have recently been extended until the end of 2014. The law provides that:

a those who pay VAT on the purchase of their property will not be obliged to pay any transfer fees; and
b for those who do not pay VAT on the purchase of their property, property transfer fees are to be reduced by 50 per cent.

VAT is not added to the sale price for the purposes of calculating the property transfer fees.

Stamp duty

Cyprus stamp duty on contracts is levied at a rate of 0.15 per cent on the first €170,860 of the consideration, and 0.2 per cent for consideration values above €170,860. Stamp duty is capped at €17,086.

iv Finance and security

The most common form of security granted in Cyprus over real estate is a mortgage. The mortgage constitutes a charge on the real estate in the benefit of the lender for the security of a debt.

The Immoveable Property (Transfer and Mortgage) Law 1965 regulates mortgages in Cyprus. As previously discussed, all charges of immoveable properties including mortgages must be registered at the Department of Land and Surveys for them to have legal effect.

Where a charge is created over the property of a company, it is required by the Companies Law, Cap. 113 that the details of the charge are forwarded to the Registrar of Companies, accompanied by the charge itself, within 21 days of the date that the charge is created.

VI LEASES OF BUSINESS PREMISES

In Cyprus, there are no special provisions for leases of business premises as opposed to other types of premises. Property leases in Cyprus are generally governed by the provisions of the Contract Law subject to the restrictions introduced by the Rent Control Law of 1983 in terms of rent increase and protection of tenants against eviction.

Terms such as the length of the lease and the rent are freely determined by the parties to the lease agreement rather by any provisions of law. Throughout the agreed term of the lease (including any agreed renewals) the tenant may enjoy the security of tenure as long as it complies with the terms of the lease.

The Rent Control Act in Cyprus applies to tenancies of Cypriot (and European) nationals of both residential and business premises that are within controlled areas as defined by the law. Currently, controlled areas include properties constructed before 29 December 1999 within defined areas in towns, suburbs and rural centres.

The law provides that after the first tenancy has expired or been terminated, the rent can be agreed to be increased, by a maximum of 8 per cent of the existing rent, every two years. If there is no agreement among the parties, the rent control tribunals will determine the reasonable rent, taking into consideration several factors. In addition, the Act controls the eviction of a tenant; it introduces the norm of statutory tenant, who can only be evicted under special circumstances. Furthermore, the landlord may be ordered by the rent control tribunal to pay to the tenant damages of between nine and 18 months' rent or damages for the loss of goodwill, or both.

Another particular aspect that is common in regard to leases of business premises in prime locations is to have a lump-sum payment made by an incoming tenant to the sitting tenant to persuade the sitting tenant to give up the premises. It is a locational goodwill payment, locally known as an *aeras* (which means air in Greek).

VII DEVELOPMENTS IN PRACTICE

There have been important developments in Cyprus real estate law over the past few months. Through the introduction of certain laws, the government has taken an important step towards modernising and improving the effectiveness of the legal procedures leading to the issue of updated title deeds, to permanently solve the title deeds issue (delays in issuing title deeds and resultant difficulties for purchasers).

i Building amnesty

Many of these important developments were introduced through the three amended laws regarding a building amnesty,[3] which came into force on 8 April 2011.

The expectation of the authorities was that the chronic problems and bottlenecks that prohibited the registration of thousands of properties would be resolved as a result of the new laws forming the building amnesty. The need for the introduction of a building amnesty arose from the fact that thousands of buildings and divided building plots in Cyprus could not be registered by the Land and Surveys Department and the relevant title

3 The three laws that were amended to introduce the building amnesty are the Immovable Property (Tenure, Registration & Valuation) Law, Cap. 224, the Town and Country Planning Law No. 90/1972 and the Streets and Building Regulations Law, Cap. 96.

deeds could not be issued. This problem was due to several reasons, the most common being the need to legalise (in many instances minor) irregularities.

By implementing the new legislation, the intention of the government and Parliament is to enable the owners (or co-owners) and purchasers of property in joint ownership, through a simple and brief prescribed procedure, to legalise minor irregularities to obtain the certificate of approval and updated title of the property, or the unit in cases of building complexes. This will further safeguard the rights of thousands of purchasers who remained trapped without title deeds for many years, and at the same time will enhance the reputation of the Cyprus property market abroad.

The key features of the amended laws as outlined in the bulletin prepared by the Ministry of the Interior are as follows:

a The amnesty applies to all buildings completed prior to 8 April 2011 with a town planning or building permit and without the relevant certificate of final approval. The law provides that interested parties must submit their intention to apply for amnesty within a period of six months, which period was extended for another six months to 7 April 2012, and have a further period of three years to submit the actual application.

b The legality of the building ceases to be a prerequisite for the issuing of a title deed. It is now probable that an updated title deed be issued for a building with given irregularities. Nevertheless, those irregularities must be described on the title deed.

c It applies, *inter alia*, to existing additions or alterations to an existing building resulting in an unlicensed building density of up to 30 per cent over the approved covered area, an increase in the height or the coverage ratio of the building, and failure to comply with the minimum required distances between buildings.

d If additional building density is required because the approved surface of a building or unit in a building has been exceeded, the applicant will have to pay a compensation levy, which will be equivalent to the market value of the additional density.

e It can also apply in circumstances where occupiers of other units in a common project have made illegal additions or alterations. Those owners or purchasers of units that have no illegalities can now apply for the certificate of final approval irrespective of the fact that other parts of the project have illegalities.

f In cases of very serious irregularities, a note will be registered in the title prohibiting the transfer of the property to another person until those irregularities are removed.

g The right to initiate procedures for the issuing of an updated title deed is now extended beyond the owner to the purchasers and the relevant authority. If the registered owner or developer does not take the required steps to have the certificate of final approval issued, any purchaser of a unit in the property or co-owner can apply directly.

h Further, the relevant authorities may, from now on, liaise with each other directly and will no longer depend on the owner's initiative.

i The amended laws enable the relevant authorities to impose administrative fines on owners who fail to submit the required declarations or applications in a way that will encourage them to comply with their legal obligations.

ii Specific Performance Law

Further important developments were introduced by the government through the implementation of the new Sale of Immoveable Property (Specific Performance) Law No. 81(I)/2011 (the Specific Performance Law), which recently replaced the Sale of Land (Specific Performance) Law, Cap. 232.

The Sale of Land (Specific Performance) Law has safeguarded purchasers for a considerable time. Once the purchaser lodged the contract of sale with the district office of the Department of Lands and Surveys (the district office), the vendor (or the developer) was prohibited from reselling the property to a third party. The Law provided that once the contract of sale was duly lodged, if an application was brought before a competent Cyprus court, the court could issue an order requiring the parties to the contract of sale to perform their respective obligations undertaken in the contract.

Despite the protection that the Law provided to the purchasers, it was nevertheless recognised that it had a number of loopholes that enabled dishonest vendors to take advantage of their positions. For instance, since there is no obligation for a vendor to remove the existing mortgage that it might have imposed on a property, many purchasers were left with the threat of losing their properties as a result of the vendor (or developer) becoming bankrupt.

To eliminate such anomalies, the Specific Performance Law was approved by Parliament and came into force on the 29 July 2011. Its main provisions are as follows:

a A contract of sale of real estate can be lodged with the district office within the extended period of six months from the date of signing. This period was previously two months from the date of signing.

b Any purchaser of real estate may assign its rights and obligations under the contract of sale to an assignee. The assignment agreement can be lodged with the district office within two months of its signing, provided that the original contract of sale has already been lodged with the same district office. Prior to lodging the assignment agreement, a tax clearance from the Capital Tax Office must be produced at the district office. In this way, the assignment agreement will have the same legal status as the original contract of sale.

c The real estate vendor must lodge a purchaser's contract of sale with the district office before it encumbers the real estate (by way of mortgage, for example). It is a criminal offence for the vendor to fail to comply with the above requirement.

d If there is a clause in the contract of sale that prohibits it from being lodged with the district office, that clause is considered to be void *ab initio*.

e In situations where there is an existing mortgage in a property, the purchaser of a unit in the property may pay to the lender the portion of that mortgage attributable to the specific unit. The lender must accept the payment and provide the purchaser with a mortgage release. Consequently, the contract of sale will take precedent over the mortgage, irrespective of whether the complete amount of the mortgage has been repaid. In terms of the contracts of sale that were signed or lodged with the district office prior to the above Law coming into force, the provisions for these arrangements can only be made provided that written approval is obtained by both the vendor and the lender.

f The encumbrance created by the lodge of the contract of sale with the district office secures each sum that the purchaser paid towards the purchase price or the given value of the subject matter at all times.

g The court may consider issuing a specific performance order under given circumstances in cases where the contract of sale is not lodged with the district office or in cases where the agreement is verbal. To do so, the court must consider that it is fair and reasonable, and at the same time that the rights of third parties from prior encumbrances are not affected.

VIII OUTLOOK AND CONCLUSIONS

Despite the worsening state of the Cyprus economy and growing uncertainty across the eurozone, the aforementioned anticipated developments are expected to produce an overall stability in real estate prices in 2014. The government's recent measures – the building amnesty, the updating of the country's legal system, the abolition or reduction of transfer fees until the end of 2014, the incentives for permanent residence permits and other tax incentives – are all expected to stimulate the property market.

Most importantly, the discovery of large natural gas deposits (see Section II, *supra*) holds out great prospects for Cyprus in the economic, social and political spheres. These oil and gas prospects create massive investment potential for the future of the Cyprus property market.

At the time of writing, many important projects expected to boost the market are under development, including the construction of a 1,000-berth marina with residential and leisure facilities in Limassol. In addition, the government is currently assessing submitted proposals for the construction of an oil product terminal, which will be part of an energy centre that is to include a liquefied natural gas plant and that is scheduled to start operating onshore in Cyprus by 2019.

Chapter 8

CZECH REPUBLIC

Martin Kubánek and Miroslav Dudek[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

The New Civil Code became effective as of 1 January 2014 as part of the re-codification of Czech private law. Under the New Civil Code, real estate (immoveables) is defined as

a plots;

b underground structures with their separate purpose of designation (e.g., wine cellars, underground parking or subway);

c rights *in rem* to plots and underground structures and other rights declared by law; and

d things declared by law that cannot be transferred from one place to another without their essence being violated (e.g., apartment units).

The New Civil Code follows the Roman law principle *superficies solo cedit*, under which buildings and other structures firmly connected with the plot are not individual objects of legal relationships but legal parts of the plot. Therefore, the owner of the plot shall generally also be the owner of the building. Yet, due to the fact that the former Civil Code did not follow this principle, the New Civil Code contains transitional provisions regulating separate ownership to plots and buildings placed on them.

Czech law differentiates between the following types of ownership: ownership right, co-ownership and matrimonial co-ownership.

The ownership (co-ownership) may be acquired under a purchase agreement, deed of gift or another agreement, inheritance, decision of a state authority, or by virtue of other circumstances stipulated by law, such as usucaption (acquisitive prescription).

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Under Czech law, a possessor of real estate will become owner of the real estate under certain statutory conditions if it has had the real estate in its possession continuously for 10 years (ordinary usucaption), or alternatively for 20 years (extraordinary usucaption).

Regarding co-ownership, all co-owners incur rights and obligations jointly and severally from legal acts relating to the joint object. The co-owners decide on the management of the co-owned object by a simple or qualified majority of votes calculated on the basis of the size of their shares.

ii System of registration

Under Czech law, real estate generally has to be registered in the Land Registry; exceptions to this principle are set out by the law. The transfer of ownership (and the creation of other rights *in rem*) regarding registered real estate generally must be entered in the Land Registry. Registration constitutes ownership (and other rights *in rem*); therefore, ownership of real estate may only be transferred on the basis of a legal title (e.g., a purchase agreement) followed by registration in the Land Registry. There are a limited number of exceptions to this principle when the legal title by itself without an entry in the Land Registry is sufficient for transferring ownership (e.g., usucaption). Ownership of real estate that is not subject to registration in the Land Registry is transferred solely on the basis of the legal title (e.g., a purchase agreement).

Any person who is a party to the legal title (e.g., purchase agreement) may file an application for registration with the competent Land Registry Office. Depending on the nature of the registration, specific documents must be attached (e.g., a purchase agreement or excerpt from the commercial register of a foreign entity). In practice, registration in the Land Registry takes between two and four weeks.

Czech law is about to abandon the principle of restricted material publicity, under which any person who relies on information in the Land Registry after 1 January 1993 is in good faith that the entry in the Land Registry corresponds to the real state of affairs, unless the person knew that the records are not in accordance with reality. In the case of a discrepancy between the entry in the Land Registry and reality, reality shall prevail. According to the New Civil Code, the principle of full material publicity shall apply; however, according to the transitional provisions, it shall only apply from 1 January 2015. In line with this principle, the New Civil Code enables the acquisition of ownership of real estate from a non-owner if certain statutory conditions have been met, especially the good faith of the transferee as regards the records in the Land Registry (the transferor must be registered as the owner), and a consideration for the ownership transfer is to be regulated in the transfer agreement (purchase agreement). The real owner of the real estate may, under certain circumstances, dispute the ownership of the new registered owner by filing a notice of dispute at the competent Land Registry Office within the statutory period.

iii Choice of law

Generally, in accordance with Czech international private law, the parties may under stipulated conditions choose the law that will apply to the agreement; however, certain mandatory provisions of Czech law must be considered: the regulation of rights *in rem* (such as ownership right and its acquisition) to real estate in the Czech Republic is governed (irrespective of the law chosen by the contractual parties) by Czech law, and formal requirements set by Czech law for the agreement on the transfer of real estate must be fulfilled. Furthermore, the provisions of Czech law regarding the registration into the Land Registry shall apply.

II OVERVIEW OF REAL ESTATE ACTIVITY

The Czech real estate market is slowly recovering from the global credit crunch and worldwide recession of 2008–2010. After a drop in real estate transactions in 2009 and 2010, there was a remarkable rise in real estate investment in 2011, albeit followed by recession in 2012. Real estate investment transactions during the first three quarters of 2013 amounted to €342 million, which corresponds with the figures of 2012. The most activity was seen in the office sector, accounting for 89 per cent of the total transaction volume, with the purchase of The Park, located in Prague 4, by Starwood Capital, a US-based private equity group, being the largest single office deal ever recorded in the Czech Republic. Few (if any) retail investments are likely to conclude soon; however, expectations are that some industrial and hotel investment transactions will be closed at the beginning of 2014. The limited activity in 2013 was a result of a number of factors, but particularly because banks became highly selective and conservative about whom and which projects they would finance, and due to the terms of debt. Projects without any transferable debt or requiring new financing have more difficulty in securing investor focus, unless absolutely prime in nature.

A large amount of new office space is currently being built. Almost 255,000 square metres of new office space will be delivered to the market during 2013 and 2014. The reason for the high level of activity is that long-planned projects are being realised by major developers, and investment groups have bought various projects from smaller developers. Development activity is focused mainly in four districts of Prague with high demand for office spaces (Prague 1, 4, 5 and 8). Among the largest projects are BB Centrum Delta, City West C1+C2 and Florentinum. The vacancy rate of new built projects should gradually decline in 2014.

The growth of modern retail premises in 2013 exceeded that of 2012, 2011 and 2010, and it is expected that 2014 will show even more growth. Almost 400,000 square metres of modern retail schemes will be offered to tenants within the next two years. In the coming months, the markets will be expanded with smaller projects in the regions (e.g., OC Letmo in Brno with 7,000 square metres and Zlatá Brána in Prostějov with 8,000 square metres) and larger shopping centres (particularly Galerie Šantovka in Olomouc with 46,000 square metres and Center Kladno with 26,000 square metres). In spite of this, the development pipeline remains constrained. New projects are scarce, and especially in larger cities where extensions are more common. Retailers are cautious and are postponing expansion in the Czech Republic.

The stock of modern A-class industrial premises in the Czech Republic totals 4,400,000 square metres. Currently, almost 230,000 square metres of industrial space is under construction; 10 per cent of all developments under construction are being built on a semi-speculative basis – the basic shell is constructed, and the building only finished once tenants are secured. The vacancy rate reached 8.5 per cent in 2013, which is similar to that of 2012.

Construction statistics for 2013 show new housing supply at approximately the same level as in 2012. The number of new apartments under construction in 2013 exceeded 5,400 flats with completion expected in 2013 and 2014. Similarly to 2012, the trend of strong demand continued throughout 2013, with the most desired locations being the Prague 9, 5 and 10 districts. 2013 saw approximately the same overall results, including the number of delivered projects, commenced projects and sales.

III FOREIGN INVESTMENT

With effect from 19 July 2011, following an amendment to the Foreign Exchange Act,[2] there are generally no legal restrictions on foreigners acquiring ownership of real estate located in the Czech Republic.

IV STRUCTURING THE INVESTMENT

Generally, investors use the following two legal approaches to invest in real estate in the Czech Republic. This short review focuses only on direct investments in real estate; indirect investment based on participation in diverse real estate investment funds and investment through the establishment of a trust newly introduced to Czech law by the New Civil Code are not dealt with.

i Asset deal

Acquiring real estate through an asset deal is a popular and common form of real estate investment in the Czech Republic. The object of the transaction is the chosen real estate. The subjects of the transactions are the owner of the real estate as a seller and the investor as a purchaser. The owner of the real estate and the investor conclude a purchase contract under which the ownership right to the real estate is transferred to the investor. The investor becomes the new owner of the real estate upon the transaction's entry in the Land Registry.

The main advantage of this investment structure is its universality. The asset deal may be used when the owner of the real estate is a natural person or if the owner of the real estate is a company (a legal entity). It also provides the possibility of adjusting the object of the investment transaction with respect to the special interests and needs of the investor, by identifying the real estate in detail in the purchase contract. The legal due diligence focuses only on the real estate that is the object of the transaction.

ii Share deal

Another form of investment in real estate is a share deal. In this case, the object of the transaction is not the real estate, but the company as an owner of the real estate.

2 Act No. 219/1995 Coll.

This form of acquisition of real estate is not that widely used, as the owner of the real estate must be a company. The main advantage of acquiring real estate via a share deal is the avoidance of taxes, especially real estate transfer tax and VAT (see Section V.iii, *infra*). As the legal owner of the real estate remains the same, the acquisition of the real estate has almost no legal impact on the contracts concluded with respect to the real estate (provided the contracts do not include a change of control clause).

On the other hand, there are some additional legal risks connected with this form of transaction. As the object of the transaction is primarily the company as its owner, in addition to the real estate the actual status and corporate history of the company must be reviewed during the legal due diligence.

The purchase contract must include specific representations and warranties with respect to the real estate, as well as to the company.

Upon their acquisition, the shares of a real estate company are not subject to real estate transfer tax. No VAT or capital duty is payable on shares deals.

Regarding the sale of Czech shares, capital gains derived by non-Czech tax residents are subject to income tax (at a rate of 15 per cent for individuals and of 19 per cent for corporations), irrespective whether the buyer of the shares is a Czech resident. In addition, the buyer is obliged to withhold a security tax at a rate of 10 per cent upon payment if the purchase price is paid to non-EU or non-EEA residents. The Czech Republic, however, loses the right to tax under the most of its tax treaties (exceptions include under its treaty with Germany).

Capital gains derived by EU or EEA parent companies may also qualify for participation exemption if both the parent company and the Czech subsidiary have the required legal form and a shareholding of 10 per cent (of a share capital or voting rights) is held for at least 12 months. Capital gains derived by individuals qualify for tax exemption if they are held for more than five consecutive years (in the case of an interest in a limited partnership or a limited liability company) or three consecutive years (in the case of shares acquired in a joint-stock company in 2014; other requirements apply to former acquisitions of shares).

V REAL ESTATE OWNERSHIP

i Planning

The Czech Republic has comprehensive land-use planning and building regulations set out in the Building Code.[3] Following these rules, municipalities enact a zoning plan setting out a basic development concept for the municipality, the protection of its values, its layout plan, landscape arrangement, public infrastructure design and built-up areas. Under the terms of the Environmental Impact Assessment Act,[4] certain public and private projects that are likely to have a significant impact on the environment require a statement from the authority focusing on nature protection, and an assessment of their effects on the environment.

3 Act No. 183/2006 Coll.

4 Act No. 100/2001 Coll.

Generally, the construction of new structures (buildings) may proceed after planning and building permits have been issued. The building authority issuing the planning permit usually imposes a number of conditions to protect the environment and neighbours, and sets conditions for the issuance of the building permit. The planning permit is valid for two years or, in exceptional cases if prescribed by the building authority, for five years from the date it comes into force. The planning permit does not entitle the investor to erect the structure, which may proceed only after the issuance of the building permit.

In the building permit, the authority sets a number of conditions for the implementation and future use of the structure. The permit expires if construction has not commenced within two years of the date it came into force.

If third parties participating in the proceedings raise objections against the placement or erection of the building, these objections are also resolved in the planning permit or building permit.

A completed structure may be used following notification to the building authority or occupancy approval. Occupancy approval is required for structures whose characteristics cannot be influenced by future users, such as structures for the assembly of a larger number of persons, technical infrastructure, or structures for business and industry. After the issuance of an occupancy approval, the owner of a building may apply for a change of the permitted use of the building. The application is filed with the competent building authority, together with documentation required by the Building Code.

ii Environment

Under the applicable laws on protection of the environment, a party causing ecological damage (such as contamination of land) can be held liable. If the polluter is not known, the owner of the contaminated real property may be held liable for the contamination as a subsidiary. Under certain circumstances, however, the owner of the contaminated real property may seek financial support from the state to remedy the contamination.

Generally, the polluter must undertake measures to remedy the ecological harm. If the polluter fails to do so, it may face a fine from the competent public authority (e.g., under Act No. 167/2008, on the Prevention of Ecological Harm and its Remedy).

In the relationship between two subjects of private law, the polluter may also be held liable under the general liability for damage regulated in civil law.

Information on contaminated sites may be found in the system of evidence of contaminated sites database.[5]

iii Tax

Real estate transfer tax must be paid on the transfer of title to real estate for consideration. A new right of construction is now also subject to tax. The current tax rate generally amounts to 4 per cent of the purchase price (provided that the purchase price (including VAT, if applicable) is higher than an administrative value calculated in accordance with

5 Accessible at http://info.sekm.cz.

the respective tax laws). The seller is liable to pay the real estate transfer tax with the buyer as a guarantor. From 2014, the parties may agree that the buyer must pay the tax (the seller is not a guarantor in this case). In general, real estate transfer tax is payable by the end of the third month following the month when registration of the transfer was made in the land register. An exemption from the duty to pay real estate transfer tax is, *inter alia*, allowed for the first transfer of a family house or an apartment (including a plot of land) if occurring within five years from the moment an occupancy approval has been issued. On the other hand, a contribution of real estate into a company's share capital is subject to tax from 2014.

Until the end of 2013, the transfer of plots (except for building plots) was always exempt from tax, unlike the buildings situated thereon, which would be tax exempt after five years of approval for use or their usage. From 2014, the transfer of a built-on plot is only tax exempt if the building situated thereon complies with the five-year statutory period. This has a significant impact: for example, on the sale of newly built houses and apartments, the transfer of plot is now subject to VAT at a rate of 21 or 15 per cent). Tax exemption for the transfer of buildings applies on compliance with the five-year statutory period (otherwise taxed at 21 or 15 per cent for family houses and residential buildings of a limited size). As for the right of construction, tax exemption only applies if this right includes a building that has complied with the statutory period (otherwise taxed at 21 per cent). However, the seller may opt for taxation. VAT is paid by the buyer to the seller, and the seller must pay VAT to the competent tax authority.

The seller may be liable to pay income tax if it sells the real estate. Non-entrepreneurial disposals of the property (real estate) of natural persons are exempted provided that the party had his or her domicile there (i.e., actually lived there) for at least two years before the date of the sale, or the real estate has been owned for at least five years prior to its sale. The exemption does not apply to real estate used for business activities. A tax rate of 15 per cent for individuals and 19 per cent for companies generally applies. Non-Czech residents are obliged to report the income and calculate the tax in a tax return. Income is reduced by expenses required for its acquisition (less tax depreciation if applied) in order to set a tax base.

iv Finance and security

There are no special regulations regarding the lending of money to finance real estate, but the formal requirements set for the loan agreement must naturally be met. The legal regulations distinguish between enterprises and non-enterprises (protected by consumer law); for both categories, the loan agreement is generally regulated by the New Civil Code.

The lender will typically seek some form of security instrument – commonly a mortgage, but it is also possible to conclude a guarantee, bank guarantee, pledge over moveables, shares, ownership interest, security assignment of receivables or a contractual fine.

The mortgage agreement must be concluded in writing. The subject of the mortgage and the secured receivables shall be sufficiently specified in the mortgage agreement. The mortgage over the real estate arises with the registration in the Land Registry, or in some cases in the mortgage registry held by public notaries. Mortgage agreements can also be made in the form of a notarial deed, and may contain a clause that certifies that the mortgage agreement establishes a right of direct enforcement. The mortgage creditor is thereby enabled to enforce the mortgage immediately in enforcement proceedings, without the necessity of prior court proceedings to obtain a valid title.

VI LEASES OF BUSINESS PREMISES

Unlike the former Civil Code, the New Civil Code does not set strict formal requirements for an agreement on the lease of business premises. It is not mandatory for the lease agreement to be in written form, nor is it necessary to specify the rent or the term of the lease. Furthermore, it is not necessary for the purpose of the lease to be specifically mentioned in the lease agreement, as it suffices if the premises are in reality mainly used for business purposes. However, for sake of legal certainty practically all agreements on the lease of business premises are in written form and contain detailed provisions regarding the rent, term and purpose of the lease.

Under the New Civil Code, the agreement on the lease of business premises may be concluded before the occupancy approval has been issued by the building authority regarding the business premises that are the subject of the lease.

As the provisions regulating the agreement on the lease of business premises are dispositive and non-mandatory, the contractual parties have wide scope to deviate from the statutory provisions.

The term of the lease is not a mandatory requirement of the lease agreement. If the parties do not regulate the lease term contractually, the lease term is indefinite. If the parties agree on a lease term that is longer than 50 years, it is deemed that the lease term has been concluded for an indefinite amount of time; within the first 50 years, the lease can only be terminated on the basis of agreed-upon reasons and within the agreed termination period. Lease agreements concluded for an indefinite period can be terminated without stating a reason. The notice period is six months, unless the party has serious reason, in which case the termination period may be three months. However, the parties are free to agree on the reasons for the premature termination of the lease agreement, or on another termination period.

Lease agreements with a lease for a definite term can be terminated prematurely based on a termination notice with a three-month termination period by specifying one of the reasons regulated by the New Civil Code. The statutory reasons for termination of the lease are usually in connection with the breach of an obligation by the other contracting party. The statutory reasons for termination of the lease can be excluded or modified by the agreement of the parties. The parties may further stipulate other specific termination reasons in the lease agreement.

If the lease is terminated based on the landlord's termination notice due to other reasons than the tenant's breach, the landlord is obliged to provide the tenant with compensation for customers that were taken over by the landlord or new tenant.

In general, the contracting parties are free to negotiate the rent price and, therefore, any rent increase. The rent increase is usually bound to some objective criterion, such as inflation or some kind of index (e.g., the consumer price index), and the calculation is usually very complex. Besides the rent, the contractual parties usually regulate the tenant's payments for auxiliary services provided by the landlord according to the lease agreement (e.g., electricity, cleaning).

For the purpose of securing the fulfilment of the tenant's monetary obligations arising from the lease agreement, a security deposit (or a bank guarantee) amounting to three to six months' rent is common practice.

If the parties do not stipulate otherwise in the lease agreement, the tenant is allowed to sublease the premises only with the consent of the landlord. The consent must be in writing if the lease agreement is in writing.

The tenant has a duty of due managerial care as regards the premises to prevent damage from occurring. The New Civil Code does not regulate insurance; nevertheless, it is a very common obligation in lease agreements to ensure the insurance of the premises. The costs of insurance are usually borne by the tenant.

Regarding the change of control regulation, the New Civil Code generally prohibits termination of the lease due to the ownership transfer of the leased premises by both the tenant and the landlord. The regulation is non-mandatory, and the parties may agree otherwise.

The landlord must maintain the premises in good condition to ensure complete and peaceful exercise of the tenant's rights in accordance with the agreed or usual purpose of lease; on the other hand, the tenant is obliged to carry out the ordinary maintenance of the premises. If the tenant cannot use the premises properly, it is entitled to claim adequate rent reduction.

The New Civil Code has also introduced the new legal institute of tenement, which is to be distinguished from a lease.

VII DEVELOPMENTS IN PRACTICE

As already mentioned, the New Civil Code, which replaced the former Civil Code adopted in 1964, came into effect on 1 January 2014. Therefore, transitional provisions of the New Civil Code regulating the relations between the old and new regulations and new legal institutes introduced by the New Civil Code are of vital importance.

i Transitional provisions

Generally, legal relations created before 1 January 2014, as well as rights and obligations arising out of these relations, shall be governed by the former legislation. As outlined below, in certain cases the New Civil Code modifies this general rule.

The legal relations regarding the right *in rem* shall be governed by the New Civil Code.

In accordance with the principle of *superficies solo cedit* anchored in the New Civil Code, structures firmly connected with the plot have become parts of the plot. However, the plot and the structure shall continue to have different tax regimes, especially as far as tax depreciation is concerned. Nevertheless, there are many cases in which the owner of the plot was, as of 1 January 2014, different from the owner of the structure placed on it. In these cases, the structure has not become the part of the plot, and the owners have a mutual statutory cross pre-emption right to the plot and the structure.

As regards rights and obligations under lease agreements, these are regulated by the New Civil Code, irrespective of when these agreements were concluded. Nevertheless, the creation of the lease, as well as rights and obligations that arose before the effectiveness of the New Civil Code, are regulated by the former legislation.

ii Right of construction

Anyone who intends to build a new structure whose service life will not exceed several decades and who does not want to purchase the plot, or anyone who cannot agree with the owner of the plot to purchase it, might find the new institute of right of construction useful. The right of construction can be established based on an agreement and by means of registration in the Land Registry. The main feature of the right of construction is its temporary nature. It can be established for up to 99 years, but can be extended later. As a result of termination of the right of construction, the structure becomes a part of the plot upon which it has been built. To compensate the builder, the owner of the plot shall pay half of the price of the structure, if not agreed otherwise between the parties. The right of construction (together with the structure) is transferable and may also be encumbered in favour of third parties.

The Income Taxes Act does not regulate the right of construction. Therefore, it is unclear whether, for tax purposes, the right of construction will be deemed as a long-term asset, whereby consideration for the provision thereof will be depreciated throughout the period for which the right was established. This procedure would reflect the economic similarity of the right of construction to the lease of land. Another option is that a construction payment could be capitalised and subsequently depreciated as part of the acquisition cost of the building that is to be constructed under the right of construction. The right of construction is not subject to real estate tax – only the constructed building will be subject to taxation.

VIII OUTLOOK AND CONCLUSIONS

The New Civil Code has introduced a large number of changes and new legal institutes into Czech law. Since some of these provisions are rather unclear or allow for more than one interpretation, there will be a certain amount of legal uncertainty until the higher courts have issued respective decisions and unified their practice. However, this will only happen in three to five years at the earliest.

Since the banks still remain very cautious and reluctant to finance projects, the outlook for greater development in the Czech real estate market is rather poor. Transactions are likewise few, as pre-crisis buyers are holding out for higher prices for their real estate; potential buyers, on the other hand, continue to wait for real estate prices to drop.

Chapter 9

ENGLAND & WALES

David Waterfield[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

The two main types of ownership of real estate in England and Wales are freehold and leasehold. Freehold is in effect absolute ownership for an indeterminate period, whereas leasehold is a right to possession and use of land for a limited period; the lessor retains its interest and grants the leasehold interest to the lessee for the term of the lease. Ownership of land also includes ownership of any buildings or other structures attached to the land and, as a general rule, includes the subsoil beneath and the airspace above the land.

Generally speaking, freehold interests are more attractive to investors because they are not subject to termination and there are fewer restrictions on the owner, whereas a lessee is constrained by the terms of a lease. That said, leasehold interests are often held for investment purposes. In central London in particular, properties may be owned by the Crown Estate, trusts, charities or other entities that may choose not to dispose of their freehold interests as a matter of policy, and will instead grant long leases. It is also common for leaseholds to be used when structuring joint ventures, and other arrangements and structures where owners wish to retain an element of control by imposing positive covenants.

A leasehold property held on an investment basis should be distinguished from an occupational lease, which is typically granted for between five and 20 years subject to a market rent and therefore has a negligible capital value. An investment leasehold interest will most likely be granted for a term of between 99 and 150 years, at a premium. There are generally fewer onerous obligations on the lessee of a leasehold property held on an investment basis. The income generated from most investment properties is in the form of rent paid under occupational leases.

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A relatively new form of land ownership called commonhold was introduced in England and Wales by the Commonhold and Leasehold Reform Act 2002. Commonhold comprises a freehold unit within a larger development and membership of the company that manages the common parts. As such, commonhold is suitable for residential flats as well as commercial developments such as shopping centres; however, its use has not been adopted by the property industry and it remains a rarity.

ii System of registration

Most freehold and long leasehold titles are registered at the Land Registry; however, a number of unregistered titles remain, and these will generally only become registered once there has been a dealing with the land that triggers a requirement for 'first registration'. The trigger events include sales, mortgages and leases granted for more than seven years. Until a trigger event occurs, titles will usually remain unregistered. Registration fees are payable, calculated by reference to the type of transaction and the price paid.

Registration at the Land Registry provides a state guarantee of title. Compensation is payable if loss is suffered as a result of a mistake on the register. Therefore, there is no separate US-style title insurance regime. The registered title has a unique title number and identifies the extent of the land on a plan. The register also provides details of the property, including any rights that benefit it, and identifies the owner and any rights or matters adversely affecting the property, including financial charges. If the property is leasehold, brief details of the lease are included. Various short leases and rights of occupation are not, however, required to be registered in their own right. These and some other non-registrable interests will bind a purchaser, and should be uncovered by the purchaser's due diligence process. Accordingly, the information on the register cannot be treated as being totally comprehensive. Documents and other information held by the Land Registry are widely available to the public, although it may be possible to protect certain commercially confidential provisions for a limited period.

iii Choice of law

Dealings with real estate in England and Wales will be covered by the law of England and Wales. Although a contract may include an express choice of governing law, which in general the courts will uphold, English law will still apply in relation to the transactional formalities that involve English and Welsh real estate.

Real estate law in England and Wales is different from real estate law in Scotland, Northern Ireland, the Channel Islands and the Isle of Man, and thus specialist advice will be required where these jurisdictions are involved.

II OVERVIEW OF REAL ESTATE ACTIVITY

One of the key consequences of the credit crunch has been a polarisation of the UK real estate market between primary and secondary assets. Prime central London properties in the crucial City, West End and Docklands markets have remained extremely attractive to overseas investors but, beyond these hot spots, the picture remains less positive. London's position as a true world city with global appeal remains undiminished, and it continues to attract a disproportionate share of investment capital. Its culture, language, schooling and further education also make it an attractive place to live as well as invest, and a high level of professional services is available to facilitate investment transactions. However, as competition for prime central London stock intensifies, there are indications that investors are prepared to look further afield for value, and we are beginning to see some evidence of the green shoots of recovery in at least parts of the wider UK market.

In the office sector, central London investment volumes have continued to increase as overseas investors are facing increased competition from domestic institutions. There has also been significant interest in flexible high-tech space aimed at the UK's innovative technology, media and fashion companies and located in creative hubs such as 'Silicon Roundabout' between the City and East End. Outside the prime locations, the retail sector remains weak, and high-profile tenant insolvencies have continued. However, pressures on the high street have been offset by the success of high-profile destination schemes such as Westfield Stratford City and also by demand, fuelled by the internet-based economy, for large distribution centres at key transport hubs. In the residential sector, the prime central London market remains strong, and there has been a material improvement in sentiment across the UK. Housebuilders have seized upon the improved conditions, the government's Help to Buy and Funding for Lending schemes have opened the mortgage market, and demand for rental property remains strong. Student accommodation also remains a growth area, backed by projected increases in the numbers of UK and international students coming into higher education.

Despite an increase in confidence in the banking sector, the availability of debt finance remains below that of pre-credit crunch levels. New sources of funding continue to fill the gaps left by the banks, and new entrants to the debt finance market have included fund managers, insurance companies and sovereign wealth funds. Banks also remain under pressure to dispose of underperforming real estate-backed loan portfolios, and non-core divisions or 'bad banks' have been created to focus on the disposal of these unwanted assets. Some €13 billion of non-performing loans were traded by UK banks in the first eight months of 2013, and the packaging and sale of these assets seems likely to continue. The government is preparing to issue a £200 million property-backed sukuk in 2014, and shariah-compliant finance may offer a developing source of funding for UK real estate and infrastructure. London also won the first offshore renminbi issue, which can only strengthen ties with China as the government seeks to encourage Chinese inward investment.

III FOREIGN INVESTMENT

Overseas investors are able to own, sell and lease real estate in England and Wales without any legal restrictions. A legal opinion may be required to confirm that an overseas investor has legal power to enter into a transaction involving property in England and Wales, to deal with the property and to execute the relevant documents.

IV STRUCTURING THE INVESTMENT

A number of alternative structures are available for direct or indirect investment in real estate in England and Wales. The decision how best to structure an investment is likely to be dictated by tax considerations, and it is important to ensure that appropriate tax advice is sought, taking into account both UK tax legislation and that of the investor's own jurisdiction. There are, however, a number of advantages and disadvantages to each structure, which may also prove critical depending on the investor's particular objectives.

i Corporate entity

A company can hold assets in its own name and create floating charges. There is potential for flexibility in terms of share structure, and there can be the advantage of limited liability. More generally, corporate entities are widely recognised, and can promote a strong and legitimate identity. Nonetheless, there is a lack of confidentiality in comparison with other investment structures and the added administrative burden of complying with the relevant regulatory framework. There is also a lack of tax transparency, and it may be expedient to base the company offshore.

ii General partnership

Whereas property co-ownership is not in itself sufficient, the active, joint management of property may constitute a partnership; it is a matter of substance rather than form. The main advantage is tax transparency, while the main disadvantage is the unlimited liability of the partners.

iii Limited partnership

In a limited partnership, investors will be limited partners who are only liable to the extent of their investment. This limited liability is particularly advantageous when coupled with the tax transparency that, to an extent, is offered by a limited partnership. However, a limited partnership must comply with the Limited Partnerships Act 1907, and a limited partner should not become involved in the management of the partnership. This may prove to be unduly restrictive for investors looking to actively manage their real estate investments.

iv Limited liability partnership

Limited liability partnerships (LLPs) are governed by the Limited Liability Partnerships Act 2000 and combine limited liability for members with the tax transparency of a partnership. LLPs are not subject to the same restrictions as limited partnerships, and partners are able to actively manage the business of the LLP. Furthermore, an LLP is a body corporate (having a legal entity separate from that of its members), and so there are no issues as to the legitimacy of floating charges. If the LLP is a collective investment scheme, it must be operated by an authorised person in accordance with the Financial Services and Markets Act 2000 (the FSMA).

v Property unit trust

A property unit trust is an open-ended fund that allows pooled investment and is tax-efficient. A unit trust is governed by a trust deed, and as such may be an unfamiliar structure to certain overseas investors. One drawback may be the need for authorisation under the FSMA. Offshore unit trusts are popular, and can provide further tax advantages as a result of their offshore status; Jersey property unit trusts in particular have been used extensively in recent years. However, there may still be local regulatory supervision, and the fact that the trust must be managed outside the UK may be undesirable for certain investors.

vi Offshore vehicle

Offshore vehicles can take advantage of lighter regulatory and tax regimes. As well as Jersey, popular offshore locations include Luxembourg, Guernsey, the Isle of Man, the British Virgin Islands and the Cayman Islands.

vii Listed property company

Investing in a listed property company offers a popular means of investing in UK real estate. Listed property companies can benefit from a high profile and augmented credibility as well as greater liquidity. The drawbacks include stringent regulatory and filing obligations, and a general lack of confidentiality. In addition, listing may be costly and places extra pressure on the company management to perform. The investor also has limited control over the underlying real estate assets.

viii Real estate investment trust (REIT)

The REIT is a relatively new form of property-specific investment vehicle in the UK based on an investment structure first developed in the United States. REITs are tax-efficient, as they are exempt from tax on income and capital gains; distributions of profits are treated as property income in the hands of the shareholders. To gain REIT status, a company must comply with a number of conditions, including a requirement to be listed on the official list of the London Stock Exchange or traded on a recognised stock exchange, and proof of property rental business characteristics. Recent improvements to the REIT regime aimed at reducing barriers to entry and investment, and lowering the costs of compliance, have resulted in a significant number of new REITs, and the inclusion of REITs as institutional investors should also boost the sector.

ix Property joint venture

Joint ventures allow parties to share risk, and therefore provide a particularly attractive investment structure while the availability of debt remains constricted and investors are keen to mitigate risk exposure in a relatively muted real estate market. A property joint venture can be structured in whatever form the parties choose, and in many cases may involve more than two parties. Of course, as well as sharing risk, parties share gains and management, so joint venture provisions need to be considered carefully.

V REAL ESTATE OWNERSHIP

i Planning

The planning administration in England and Wales primarily consists of local planning authorities (LPAs) and the Secretary of State for Communities and Local Government. The Mayor of London is also able to exercise specific planning powers at a regional level. Planning administration is governed by various statutes, including the Town and Country Planning Act 1990. In general, planning permission is required for development, including material changes of use, although certain restricted types of development do not require planning permission under the Town and Country Planning (General Permitted Development) Order 1995. There are particular planning requirements for conservation areas and listed buildings, as determined by the Planning (Listed Buildings and Conservation Areas) Act 1990. Third parties have a right to make representations about any planning application, which in turn must be considered by the relevant LPA. Applicants are able to appeal any refusal of planning permission or any conditions attached to a grant of permission. In addition, LPAs have enforcement powers to deal with any development carried out without planning permission. A fundamental reform of the planning system is provided for by the Localism Act 2011. Its provisions enhance the powers of LPAs, give local communities more say over housing and planning decisions and introduce a package of measures to make the current system clearer, more democratic and more effective.

ii Environment

The environmental issue of particular significance to investors is the contaminated land regime, which is set out in Part IIA of the Environmental Protection Act 1990, as amended by the Environment Act 1995. Contaminated land is land that is causing, or may cause, significant harm to the environment or human health, and the regime also applies to water pollution. There is an obligation on local authorities to inspect their land to identify areas of contamination. Where land is deemed to be contaminated and is not being remediated voluntarily, the local authority or the Environment Agency is obliged to serve a remediation notice on the relevant persons requiring the clean-up, investigation and monitoring of the contamination. It is a criminal offence to fail to comply with a remediation notice. In general, those who cause or knowingly permit land to become contaminated are responsible in the first instance; however, if no such person can be found, the current owners and occupiers of the site may be liable for remediation costs. While the regulators in the UK do not take enforcement action as readily as in other jurisdictions, remediation costs can be substantial, and it is often necessary to obtain specialist advice when dealing with land that is or may be contaminated.

iii Tax

Value added tax (VAT)

The starting point is that a supply of land will be exempt from VAT. However, the seller or lessor can exercise the option to tax, which will make any sale or letting of the property a supply subject to VAT. The standard rate of VAT is currently 20 per cent. The lessor or seller can then recover the VAT charged on supplies of goods and services made to him or her in connection with the property concerned. In addition, supplies of land are generally subject to VAT if the sale involves a new commercial building completed within the last three years, or an incomplete industrial or commercial building.

Stamp duty land tax (SDLT)

SDLT is a transactional tax payable by the buyer on the acquisition of a chargeable interest, and applies to any chargeable consideration payable by the buyer on a relevant transaction. The rate depends on the value of the transaction, and the highest rate for non-residential transactions is currently 4 per cent where consideration exceeds £500,000. Residential properties worth more than £1 million are, however, subject to higher rates. SDLT is also payable by the lessee on the rental element of a lease on grant, and is charged at 1 per cent of the net present value of the rent payable for the term of the lease. Limited types of transactions are normally exempt from SDLT, including mortgages and personal licences to use or occupy land. There are also a number of reliefs that may apply, including group relief, sale and leaseback relief, acquisition relief, reconstruction relief and charity relief. It is important to consider how best to structure a transaction for SDLT purposes, although the introduction of various anti-avoidance provisions has made it increasingly difficult to implement tax-saving schemes.

Rates

The occupier of a business property is responsible for the payment of business rates, which fund local government expenditure and are calculated by reference to the rateable value of the property. Rateable values are assessed every five years, although the next revaluation has been postponed from 2015 to 2017. Following a significant reduction in the relief available, business rates are generally payable on empty properties, and this has become a significant issue for owners in sectors with high vacancy rates. A new empty property rate relief scheme came into force on 1 October 2013 and allows local authorities to grant relief for properties that are unoccupied for the first 18 months after completion to help encourage new development. Measures announced in the Autumn Statement, including a below-inflation 2 per cent cap on increases for 2014, aim to ease the business rates burden, particularly in the retail sector.

iv Finance and security

Lenders will generally require security over real estate, the best form of which is a charge by way of legal mortgage. It is necessary to register a mortgage over land at the Land Registry and, if the company giving the security is registered at Companies House, the security must also be registered at Companies House within 21 days of creation. A new regime for the registration of charges created by companies came into force in 2013. The mortgage will typically impose restrictions on the ability of the borrower to deal with the property and obligations on the borrower to preserve the value of the security. Security is also commonly taken over the rental income derived from occupational leases.

VI LEASES OF BUSINESS PREMISES

In general, the lessor and lessee are free to agree the terms of a commercial lease. The law does not prescribe a particular form or contents of a lease and, subject to the lessee's security of tenure referred to below, there are relatively few statutory provisions affecting the lessor and lessee relationship under a commercial lease. The Code for Leasing of Business Premises seeks to encourage fairer and more flexible terms for lessees but, despite industry endorsement, remains voluntary. Traditionally, the industry has not enjoyed a reputation for being customer-driven, and leases have tended to be lengthy and complex. That is, however, changing as owners seek to meet the needs of their occupiers. The position for commercial leases should be contrasted with that for residential leases, where statute plays a significant role.

i Term

Leases can be granted for a wide range of terms. Leasehold interests held for investment purposes are normally held on long leases for a term of between 99 and 150 years. Historically, occupational leases were granted for a term of 20 or 25 years; however, shorter terms of 15 years, 10 years or less have become more common in recent years. Market conditions mean that the trend for shorter, more flexible leases is likely to continue. A lessee of an occupational lease may also require a right to determine the lease before the end of the term. For example, the lessee of a 10-year lease may have a contractual right to determine or break the lease at the end of the fifth year of the term.

ii Rent increases

The property industry has traditionally required five-yearly upwards only rent reviews to the open market rental value of the property. This guarantees a minimum return of no less than the original rent for the remainder of the term of the lease, even if market rents have fallen. Although there has been some pressure on the property industry to offer leases on more flexible terms, it is still very rare to see rent review provisions that allow for the rent to go up or down in line with the market. An alternative form of rent review is indexation, for example in line with the retail price index or the consumer price index, but this, too, is often on an upwards only basis. Fixed uplifts in the rent are another possibility, and changes to the rent can also be restricted by agreed caps and collars. An element of the rent, particularly in large retail developments, may also be calculated by reference to turnover. VAT may be charged on the rent.

iii Lessee's right to sell and change of control

There are likely to be restrictions on the lessee's ability to sell, charge, underlet or share occupation of the property without the lessor's consent. In a typical occupational lease, consent must not be unreasonably withheld. In considering applications for consent, the lessor will be keen to ensure that a lessee of good covenant strength is responsible for paying the rent. Provisions restricting a change of control of the lessee itself are, however, rare.

iv Lessee liability and security for payment of rent and performance of covenants

The Landlord and Tenant (Covenants) Act 1995 (the LT(C)A) introduced a regime whereby lessees of new leases (granted on or after 1 January 1996) are released from liability on an assignment of the lease. The lessee's guarantor is also released at this point. This is in contrast to the previous regime, whereby the lessee and its guarantor remained liable for the duration of the term of the lease under the doctrine of privity of contract, even after an assignment of the lease. The doctrine continues to apply to old leases (granted before 1 January 1996). The LT(C)A also introduced authorised guarantee agreements

(AGAs), which provide the lessor with a guarantee from the outgoing lessee for the assignee's obligations under a new lease. The AGA is for the duration of the assignee's term only, so that when the lease is assigned again, the original lessee is released from all liability. The decision in *K/S Victoria Street v. House of Fraser (Stores Management) Ltd and others*[2] confirmed that, although a lessee's guarantor cannot be required to guarantee the liability of an assignee, it can guarantee the lessee's obligations under an AGA given by the lessee in respect of the assignee. A lessor will also consider other security, including a rent deposit or bank guarantee.

v Repair and insurance

A lessee of business premises will usually be expected to be responsible for all liabilities in respect of the property, including maintenance and repair costs. Where a property is multi-let, those costs are recovered through a service charge. The lessor generally insures the property but recovers the cost of the premiums from the lessee. As a result, leases of business premises are often known as full repairing and insuring (FRI) leases. An FRI lease is important for the UK real estate investment market, as it allows the lessor to receive a clear income stream.

vi Collateral warranties

For investors in a property that has been recently constructed, collateral warranties provide investors, funders and other third parties with a contractual link that can be used to enforce the performance of the duties of the professional and construction teams. Third parties can also be given equivalent rights under the Contracts (Rights of Third Parties) Act 1999.

vii Termination

If the lessee fails to pay the rent or is in breach of any of its other obligations, generally the lessor is entitled to bring the lease to an end by forfeiture; however, the lessee is given the opportunity to remedy the breach and can apply to the court for relief. The lessor's right to forfeit also normally applies if the lessee of an occupational lease becomes insolvent.

viii Security of tenure

The Landlord and Tenant Act 1954 (the LTA) provides security of tenure to lessees of commercial properties in England and Wales. If the property is occupied for business purposes, the lessee has the right to remain in occupation at the end of the term of the lease and is entitled to apply for the grant of a new lease on substantially the same terms; however, the lessor may be able to resist the grant of a new lease based on one of the grounds prescribed by the LTA. The most common ground relied on in practice is that the lessor plans to redevelop the property. This ground is not always easy to establish and, if the lessor is successful, the lessee may be entitled to compensation. Security of tenure

2 [2010] PLSCS 278.

can be a valuable statutory right for lessees, and can have a significant impact on a lessor's plans for dealing with its property, including future development plans. It is possible for the lessor and lessee to agree to contract out of the security of tenure provisions of the LTA. To contract out, a notice must be served on the lessee explaining that security of tenure is to be excluded, and the lessee must make a declaration acknowledging this before the lease can be entered into. Contracting out tends to be more common in relation to short-term leases.

ix Mixed-use developments

Mixed-use developments are generally permitted in England and Wales, and have become a facet of urban renewal. There are specific issues relating to mixed-use developments, including increased levels of statutory protection for residential lessees. Residential lessees' rights include collective enfranchisement and individual lease extension rights, as well as the right of first refusal and protection in relation to service charges and the management of the property.

VII DEVELOPMENTS IN PRACTICE

i Break clauses

Two recent cases have given tenants some comfort in connection with the difficulties that can arise where a tenant seeks to exercise a conditional right to break a lease before the end of the contractual term. In *Marks and Spencer Plc v. BNP Paribas Securities Services Trust Company (Jersey) Ltd*,[3] the court implied an obligation on the landlord to repay any rent paid by the tenant in respect of any period after the break date. The break clause was conditional on there being no arrears as at the break date, and the payment of a penalty or break fee. Although this is good news for tenants, landlords will undoubtedly argue that the decision is confined to its facts, and that a repayment obligation should not be implied in the absence of a break fee or penalty.

In *Siemens Hearing Instruments Ltd v. Friends Life Ltd*,[4] the court decided that a break notice that did not comply with the strict requirements of the lease was, nonetheless, valid. Despite accepting that non-compliance with any of the conditions to the exercise of the break would be fatal, the tenant's failure to expressly refer to a specific statutory provision in the notice was not. The specific wording had been rendered meaningless by subsequent case law, and the court ruled that its omission should not invalidate the tenant's break notice. Notwithstanding this decision, tenants should aim to comply strictly with the conditions attached to the exercise of a break right.

ii Fracking

The government has confirmed its support for the exploitation of shale gas to provide energy for the UK, the Autumn Statement announced a new tax allowance for onshore

3 [2013] EWHC 1279 (Ch).

4 [2013] AII ER 188.

oil and gas, and local authorities will be able to retain all the business rates collected from shale gas schemes in their areas. In addition to providing greater energy security, the government believes that a shale gas boom will boost employment and promote economic growth. There are estimated to be 1,300 trillion cubic feet of shale gas deposits in the UK. Planning guidance for the exploitation of onshore oil and gas has been published, and this provides advice on the planning issues associated with the three phases of onshore gas extraction: exploration, testing and production. In addition to the need for planning permission from the relevant Minerals Planning Authority, operators will need to obtain a petroleum licence under the Petroleum Act 1998, and also be granted the necessary property rights from the relevant landowners to work and extract the gas. Failure to obtain the necessary property rights may result in a claim for damages in trespass, as was the case in *Bocardo SA v. Star Energy UK Onshore Ltd*,[5] where pipelines passed through an adjoining owner's land without consent. An operator will also need to involve other bodies, including the Environment Agency and the Health and Safety Executive. Despite the government's support, fracking remains a controversial process that has attracted significant resistance from environmental groups and local inhabitants.

iii Planning developments

The government has taken steps to allow greater flexibility for change of use to help meet the UK's acute housing shortage. A new permitted development right to convert offices to homes without the need for planning consent has been introduced, and there are proposals to allow retail premises to be converted to residential uses and other premises to be converted to nurseries and state-funded schools. Planning permission is still required in respect of any associated physical conversion works to the building. Although a number of local planning authorities have applied to opt out of the offices to homes right, the government has only granted a limited number of exemptions, mainly to London boroughs.

Regulations have extended the nationally significant infrastructure projects (NSIPs) consent regime to major new developments that are of national importance. This should mean that planning decisions for qualifying large-scale developments are made within 12 months under the fast-track NSIPs system.

Finally, proposed amendments to the community infrastructure levy will help address concerns about the current regime, including the risk of double charging where the building has not been in continuous use.

iv Annual tax on enveloped dwellings (ATED)

The Finance Act 2013 introduced the new ATED. It applies where a residential property with a value of more than £2 million is held by a non-natural person, such as a company, a partnership where a partner is a company or a collective investment scheme. The annual charge ranges from £15,000 to £140,000 and depends on the value of the property. A number of reliefs are available, including where the property is held as part of a property rental business, or by a company carrying out a property development trade or buying

5 [2010] UKSC 35.

and selling properties as a trade. ATED forms part of a package of measures aimed at dissuading individuals from acquiring residential properties through special purpose vehicles, and is in addition to the 15 per cent SDLT rate that applies where a high-value residential property is acquired by such a vehicle. Purchasers will need to balance the privacy and tax advantages associated with using a corporate wrapper against the onerous SDLT and ATED liabilities.

v Tenants and insolvency

Despite improvements in the economy, the struggling retail sector continues to be plagued by a succession of high-profile tenant failures. High street casualties in 2013 included Blockbuster's UK arm, Barratts Shoes and HMV, and reports indicate that a significant number of retailers remain at risk of insolvency.

A number of landlords affected by the administration of the Game group of companies in 2012 have lodged an appeal with the Court of Appeal that seeks to overturn the principles in *Leisure (Norwich) II Ltd and others v. Luminar Lava Ignite Ltd (in administration) and others* [6] and *Goldacre (Offices) Ltd v. Nortel Networks UK Limited (in administration)*.[7] These cases confirmed that where rent is payable in advance and payment falls due before the commencement of the administration, no part of the rent is payable as an expense of the administration. Game went into administration on 26 March 2012, the day after the March quarter day, and no rent in respect of that quarter has been paid. The landlords will argue that the rent for the March 2012 quarter is payable as an expense of the administration. If successful, the landlords are likely to recover the full sum as an administration expense, rather than having to rank equally with the other unsecured creditors. The appeal is due to be heard in early 2014.

Landlords remain concerned about the lack of transparency within the insolvency process and, in particular, pre-packaged administrations. The Insolvency Service has instigated a review into whether pre-packs operate in the interests of creditors and the wider economy.

vi Overriding interests

As mentioned above, a registered title does not provide a comprehensive picture of all the matters that affect the title to a property. Matters that do not need to be protected by registration are known as overriding interests. With effect from 12 October 2013, a number of these interests, including chancel repair liability, ceased to operate as overriding interests and will not bind a purchaser of the land for valuable consideration, whether or not the purchaser had notice, unless the interest had been protected by registration. Chancel repair liability is linked to the UK's historic tithe system, and imposes an obligation on the owner of certain land to contribute to the cost of repairing the local church. The loss of overriding interest status should mean that, over time, fewer transactions will be affected by any potential liability.

6 [2012] EWHC 951 (Ch).

7 [2009] EWHC 3389 (Ch).

VIII OUTLOOK AND CONCLUSIONS

Significant appeals to be heard by the Court of Appeal in 2014 include the appeals of the landlords in the *Marks and Spencer* and *Game* cases (see Section VII, *supra*). The Law Commission is considering the responses to its consultation on rights to light. The project seeks to achieve an appropriate balance between the rights of landowners and the need to facilitate development, and a final report is anticipated in late 2014. The Law Commission is awaiting the government's responses to its recommendations in relation to the law relating to easements and covenants, and in relation to the Electronic Communications Code. A new regime for the recovery of commercial rent arrears is due to come into force in April 2014. Commercial rent arrears recovery (CRAR) will replace the somewhat archaic remedy of distress, which allows landlords to seize a tenant's goods. CRAR will offer greater protection to tenants, but landlords will lose some of the impact distress can provide in appropriate circumstances. The Association of British Insurers and the government have entered into a memorandum of understanding to develop Flood Re, a not-for-profit scheme that should ensure that flood insurance remains widely available and affordable. Flood Re is expected to be up and running in 2015, but will not extend to commercial properties or homes in the highest council tax band. In relation to infrastructure, political uncertainty seems likely to continue in relation to the options for a London hub airport, and the viability of the HS2 high-speed rail link between London and major cities in the Midlands and the North.

Although there is no room for complacency, the UK continues to be an important part of the global real estate investment market. The appeal of prime central London properties with the benefit of a strong covenant remains undiminished, and we are starting to see a trickle-down effect in the secondary and regional markets. World demographics indicate a rapidly expanding amount of capital will be available for investment combined with a growing appetite for cross-border investment. High-net-worth individuals remain a fast-growing investor group, particularly in Asia, and there will also be significant growth in global savings and pension funds. This points to an increasing amount of capital available for investment in the global and UK real estate markets. However, to remain competitive, the UK must work hard to meet the requirements of overseas investors to continue to attract global investment capital. Areas of concern include the need for an investor-friendly tax regime, flexible planning laws, an acceptable immigration policy, a fully functioning hub airport and other infrastructure, and the preservation of London's status as an international centre of legal excellence. The investment opportunities offered by the world's emerging economies will undoubtedly provide stiff competition over the medium to long term.

Chapter 10

FINLAND

Samuli Palin and Leif Laitinen[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

The main forms of ownership in Finland are direct ownership of real estate and ownership through a limited liability company. Direct ownership means that owner of the real estate possesses the land and the buildings on it. It is also possible to own only the buildings and lease the land from the landowner. Ownership through a limited liability company constitutes indirect ownership of real estate, meaning that ownership and possession of the real estate can be differentiated from each other.

A limited liability company can be structured either as an ordinary real estate company (OREC) or as a mutual real estate company (MREC). ORECs and MRECs administrate real estate by virtue of ownership or land lease agreements. If an OREC owns buildings located on the real estate administered by it, the OREC, in its capacity as a lessor, enters into a lease agreement with the tenants and receives all the rental income from the tenants. All operating and maintenance costs of an OREC relating to real estate are borne by the company and covered by the lease payments and possible capital contributions from the shareholders.

In contrast with an OREC, the articles of association of an MREC contain provisions that allocate various premises to its shareholders. The shareholder (or shareholders as the case may be) possesses the premises allocated to it in the articles of association, and enters into a lease agreement with a tenant regarding such premises, and receives the rental income for the premises directly. Therefore, the shareholder (and not the MREC) is the lessor of each premises or building owned by an MREC. To cover the operating and maintenance costs of an MREC, the shareholders must pay maintenance

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charges to an MREC, the amount of which is defined from time to time by the general meeting of the shareholders of the respective MREC.

ii System of registration

The acquisition of title to real estate must be registered with the title and mortgage register held by the National Land Survey of Finland within six months of signing the deed of transfer or other document on which the acquisition is based. Failure to submit the application within this period generally results in the increase of transfer tax. The registration gives protection against possible transfers of the real estate to other purchasers. It should be noted, however, that a purchase of shares in an OREC or MREC does not trigger a registration obligation, as the transfer does not change the owner of the real estate.

The holders of a fixed-term land lease or other usufruct on real estate must also apply for registration of their right in certain situations. In addition, Finnish law recognises several other special rights, which can be registered. Although not compulsory, it is advisable to register such special rights with the land register to secure the right to use the land in relation to future owners of the land, other owners of special rights and creditors of the landowner. The Finnish state is responsible for ensuring the information entered into the title and mortgage register is correct, and is liable to pay damages if errors in the register cause damages.

iii Choice of law

Finnish legislation does not contain specific provisions regarding the choice of law in relation to the sale and purchase of real estate. In practice, the sale and purchase of real estate located in Finland must be governed by the laws of Finland on the basis of the *lex rei sitae* rule. With regard to the sale and purchase of an OREC or MREC, the governing law may be freely agreed upon; however, the market practice is that the respective purchase agreement is under Finnish law.

II OVERVIEW OF REAL ESTATE ACTIVITY

In general, the total real estate transaction volume has stayed at a low level for the fourth consecutive year. This trend appears set to continue, and it is estimated that the volume for 2013 may not even reach 2009's record low figure of €1.76 billion. According to statistics published by KTI Property Information Ltd,[2] the total real estate transaction volume in 2012 in Finland was €2.1 billion, which is an increase of approximately 17 per cent compared with the previous year. The final figure for 2011 was approximately €1.8 billion. Based on the same source, the activity in 2010 was €2.39 billion. Domestic institutional investors (in particular pension insurance companies) dominated the real estate investment market in 2009, but international investors returned in 2010 and this trend also continued in 2013. Swedish and German investors have been the most active international investors in 2013. According to KTI Property Information Ltd, foreign

2 A Finnish property research organisation.

investors accounted for approximately 23 per cent of the total transaction volume in 2012.

The economic instability in Europe has affected the availability, conditions and margin of bank financing, with investors experiencing difficulties in achieving financing on satisfactory terms, especially for non-core properties; on the other hand, the lack of core properties in the market means core investors are having problems finding properties that meet their investment criteria. Loan-to-value ratios have remained at a moderate level compared with the pre-debt crisis era. Finnish listed property companies have also used capital market instruments (e.g., rights or corporate bond issues and hybrid loans) as alternative sources of financing. In spite of low transaction volumes and the tight availability of debt financing, new Finnish property funds have been established during 2013 (targeted, in particular, to care and residential properties).

Geographically, the Helsinki Metropolitan Area (the HMA, comprising the cities of Helsinki, Espoo and Vantaa) is the dominant real estate market in Finland. According to KTI Property Information Ltd, the HMA represented approximately 54 per cent of all transactions in 2012. Investors appear set to maintain this focus in 2014. Core office properties in the HMA are particularly in demand, but very few are for sale. Other major cities outside the HMA (Tampere, Turku and Oulu) are also targeted by investors in certain respects.

III FOREIGN INVESTMENT

There are no restrictions on foreign individuals or entities buying or owning shares or real estate in Finland, except in the province of Åland, where only those with a domicile right are entitled to own or possess real estate. There are no specific reporting requirements for foreign individuals or entities; however, the Finnish municipality where the real estate is situated has a pre-emption right if the real estate has an area of over 5,000 square metres, except in the HMA, where the threshold is 3,000 square metres. Even though the pre-emption right is not commonly used, the purchasers of such real estate face the theoretical risk of being supplanted by the municipality as the purchaser; it is possible to seek from the relevant municipality a waiver on use of this right. Typically, foreign investors acquire interests in property through a real estate company and, since the ownership of the real estate does not change in connection with the purchase of the company's shares, the pre-emption right is not triggered.

IV STRUCTURING THE INVESTMENT

The Finnish legal system recognises limited companies (which may be either public limited or private limited companies), partnerships, limited partnerships and cooperatives. MRECs and ORECs are private limited companies.

The acquisition structure for real estate depends on whether the property is being acquired directly (by incorporating a Finnish company for the purpose of acquisition) or through the acquisition of shares in a Finnish company. In the case of an indirect acquisition, each Finnish target company (an OREC or MREC) is typically acquired by the (same or different) newly established Finnish private limited company (HoldCo).

Following acquisition, the target company can be either converted into an MREC or merged with the HoldCo, which is then converted into an MREC. Both the conversion to an MREC and the merger are generally neutral for tax purposes. In the case of a direct acquisition of real estate, each property is typically acquired by the (same or different) newly established OREC or MREC. If the acquisition vehicle is an MREC, it should be established by a HoldCo, as most tax treaties concluded by Finland give it the right to tax capital gains derived by non-resident sellers from the sale of shares in an MREC. Direct acquisitions are not as common as indirect acquisitions because of the higher transfer tax rate (see Section V.iii, *infra*).

The advantage of an MREC is that the rental cash flow passes straight to the shareholder of the company. If charges paid by the HoldCo to the MREC equal the cost of the MREC, this structure practically eliminates taxable income for the asset-owning MREC. ORECs, if leveraged prior to acquisition and refinanced in respect of the acquisition with shareholder or external loans, typically make no taxable profit because of the wide deductibility of interest costs.

So far, it has not been common for real estate to be owned directly through partnership-type entities or cooperatives. Instead, limited partnerships are often used as equity funds acquiring real property directly, or acquiring shares in an OREC or MREC. This type of structure benefits investors because a partnership is transparent for tax purposes (the income received by it is taxed directly as the income of its partners). In this structure, investments are held in the form of direct ownership or through an MREC to avoid double taxation. However, lately structures with limited partnerships owning MRECs have emerged especially in construction targets due to the recent change in transfer taxation, as transfer of a partnership stake is not subject to Finnish transfer taxation.

Rental income and capital gains from the sale of shares in an MREC or OREC are taxed at the rate of 20 per cent in the hands of any corporate investors, resident or non-resident. Some tax treaties set limits on the taxation of non-resident corporate investors. Dividends from a HoldCo may be subject to a Finnish withholding tax at the same rate (20 per cent), but are typically exempt or subject to a lower rate because of the provisions of a tax treaty or domestic law (e.g., companies resident in the EEA).

A specific tax relief is provided under certain circumstances to Finnish real estate funds carrying out merely leasing activities in residential properties. Such real estate fund (exempted real estate fund) is exempted from corporate income tax. An exempted real estate fund is incorporated as a public limited company; its shares must be listed on a stock exchange within three years of its incorporation and it must distribute annually 90 per cent of its profits. It must have a minimum equity of €5 million and at least five separate investors at the time of incorporation. So far, only one exempted real estate fund has been listed on a stock exchange in Finland.

In addition, it is possible to establish a special investment fund investing directly or indirectly in any kind of real estate. Establishing a special investment fund requires the incorporation of a management company. The minimum equity of the fund is €2 million and it must have at least 50 investors; even 10 investors are enough, however, if each investor makes an investment of at least €1 million. The fund is exempted from tax on rental income and capital gains on the sale of real estate. Usually, no withholding tax is levied in Finland on profits that the special investment fund distributes to non-residents.

V REAL ESTATE OWNERSHIP

i Planning

Planning in Finland is divided into three hierarchical levels of land use plans comprising regional plans, local masterplans and detailed local plans. Furthermore, the Council of State determines national principles of land use. Regional plans containing general information are produced and approved by regional councils and further approved by the Ministry of the Environment. Local masterplans and detailed local plans are prepared and approved by municipal councils. In the event that municipalities have prepared a joint masterplan, the approval of the Ministry of the Environment is required. Local masterplans set out general land use and community structure in the area of the respective municipality, and detailed masterplans specify use of land, including the location, size and use of buildings.

The valid detailed masterplan can be amended to allow new functions in the plan area. When the local detailed plan or an amendment to it is required mainly by private interests and drawn up on the initiative of the landowner or other title holder, the local authority may charge the costs incurred in drawing up and processing the plan to the landowner or title holder concerned.

ii Environment

Environmental liability may be public or private. The main public liability for the application of remedial measures to contaminated land rests with the polluter. If the entity mainly liable for the contamination cannot be found, or cannot fulfil its remedial duty, the holder of the land usually has secondary liability to remedy the pollution. The holder is responsible for remediation unless this is clearly unreasonable. The holder is deemed to be the subject that has the actual right of administration on the premises, such as the owner, leaseholder or holder of a parcel of the land.

Private liability means liability to compensate the damages that have been caused by the activity of the polluter. Persons liable are those who have caused the environmental damage, who are comparable with persons carrying out the activity (such as employees of a company operating at the premises) and to whom the activity that caused the damage has been assigned, if the assignee knew or should have known, at the time of the assignment, about the damage. In addition to the above, the polluter may face criminal charges for its actions.

iii Tax

Transfer tax payable for the transfer of real estate equals 4 per cent of the purchase price of the respective real estate (i.e., land and buildings). Other statutory costs relating to the purchase of real estate include the notary fee (currently €112) and the registration of title fee (currently €107). The transfer tax payable on shares in an OREC, an MREC or a holding company whose assets directly or indirectly consist mainly of real estate in Finland is 2 per cent of the purchase price of the shares. In addition to the purchase price, the transfer tax base includes shareholder loans and the debt share of MRECs and housing companies on a *pro rata* basis, as well as liabilities transferred to the transferee and benefiting the transferor. As a general rule, transfer tax is imposed on the purchaser, although it is possible to agree that the seller pays the tax or that the payment is divided between the contracting parties. In the case of foreign real estate holding companies, Finnish transfer taxes are payable only if either the seller or the purchaser is a Finnish resident or a Finnish branch of a foreign financial institution.

Real estate tax is levied on holdings of real estate, excluding woodland, forests and agricultural land. Tax is levied also from non-resident owners. The general rate varies between approximately 0.6 per cent and 1.35 per cent and is calculated on the basis of the value of the real estate. Each municipality has the right to determine the rate within this range on an annual basis, which means, in practice, that there is variation between the rates. The general rate is usually applied to, *inter alia*, office and industrial buildings, although there are some exceptions relating to certain types of buildings and constructions.

iv Finance and security

The most common form of security granted over real estate is a mortgage, which is created by a mortgage deed. The real estate owner must apply for the deed to be issued and registered by a district survey office. The mortgage is registered for a fixed amount and encumbers both the underlying land and any fixtures, including buildings and uncut forest (if any) located on the land. After the deed is issued, it must be transferred to the secured lender to perfect the security interest. There must also be a pledge agreement between the mortgagor and mortgagee identifying, *inter alia*, the secured liabilities.

It is possible to grant a mortgage over land lease (or a fixed-term right of land use), provided that the lease is registered in the Finnish Title and Mortgage Register. The registration is subject to two conditions: the land lease must be transferable without the owner's prior consent and the land lease must grant a right to construct buildings or facilities on the leased real estate. A mortgage over a lease is perfected by registering the mortgage deed at a district survey office and transferring the mortgage deed to the secured lender.

VI LEASES OF BUSINESS PREMISES

The lease agreements of business premises are governed by the provisions of the Act on Renting of Business Premises. Most parts of the Act are not mandatory; therefore, the contracting parties to a lease agreement concerning business premises can freely negotiate the terms of the lease. On the other hand, the Act on Residential Leases applicable to lease agreements in the residential sector (mainly apartments) contains a number of mandatory provisions and cannot be amended to the detriment of a tenant. These include, *inter alia*, the method of payment of rent and restrictions on the lessor's right to terminate the lease in certain situations.

Basically, there are two types of lease agreements: fixed-term agreements and agreements that are in force until further notice. A mixture of these can also be used. In general, the parties to a lease are free to negotiate termination clauses; however, Finnish law provides for certain mandatory provisions, for the benefit of the tenant, regarding termination periods in respect of leases valid until further notice. Notwithstanding the provisions of a lease agreement, a tenant has, *inter alia*, a right to terminate the lease agreement with immediate effect if, for example, the use of the premises evidently endangers the tenant's health (or any person employed by the tenant), the premises or any part thereof are no longer in the possession of the tenant or the lessor has materially breached the terms of the lease agreement.

Rent can be freely negotiated between the parties. As a general rule, rents payable for the lease of business premises are fixed and paid monthly in euros. It is very common for the rent to be tied to the Finnish cost-of-living index; however, lease agreements often stipulate that rent shall not fall with a decrease in the index. In retail premises as well as in hotels and restaurants, the rent (or part of it) may be tied to the turnover of the tenant. Rental levels may also be partly determined by the tenant's credit rating.

There are only a few mandatory provisions concerning the condition of premises and related procedures and, therefore, parties to a lease agreement may freely agree upon the allocation of responsibilities concerning maintenance, repair and operation costs. Unless otherwise agreed, the lessor has responsibility for all maintenance and repair of the premises to the extent that is not the responsibility of the company that owns the building where the premises are located. Further, the premises must be, both at the beginning and during the term of the lease, in such a condition that the tenant may reasonably expect, in light of the age of the premises, the condition of premises ordinarily used for similar purposes in the area, and other local circumstances.

In practice, rental responsibilities of the parties vary significantly. The tenant may be obliged to pay gross rent while all costs relating to maintenance, repair and ownership of that premises are paid by the lessor; this type of rent is usually applied in multi-tenant office premises. On the other hand, net and triple-net rents are used in retail and industrial premises as well as in single-tenant office and logistic premises. Although all or most of the costs and responsibilities relating to the premises are covered by the tenant in the case of triple-net lease agreements, normal wear and tear is typically excluded. It is not possible to establish a bondable triple-net lease in Finland because of mandatory provisions of Finnish law. The tenant and lessor may disregard such restrictions if an additional supplementary agreement under the laws of a foreign jurisdiction is concluded between them. Accordingly, the tenant undertakes to compensate all costs and expenses relating to the lease of the premises regardless of the provisions of Finnish law.

Parties to a lease agreement can agree on reasonable security to secure any obligations of a tenant. Bank guarantees and security deposits are generally used. Parent company or third-party guarantees may also be issued as collateral.

VII DEVELOPMENTS IN PRACTICE

A new piece of legislation entered into force November 2013, enabling electronic real estate conveyance through an internet-based service provided by the National Land Survey of Finland, the organisation responsible for maintaining real estate registers. Previously, only a deed of sale in writing and attested by a notary public was valid and enforceable. The new system is linked to the title and mortgage register and automatically ensures that the deed of transfer contains all the necessary information, and that the owner information matches the register data and other information from the official registers. The transaction platform has features such as online handling of authorisations and power of attorney, and allows online drafting of the deed of sale. The presence of a notary public is not necessary, and parties do not have to be present in the same location when concluding the purchase electronically. The application for registration of the title is also automatically entered after the purchase, but granting of the title by the registration authority is not immediate yet.

The changes are focused on the procedural side of contracting and should not cause any substantial changes to real estate transactions or contracts. Security of the process is ensured through digital identification and signature, meaning the parties must be able to provide a reliable electronic identification. At the same time, the application and transfer of real estate mortgage instruments are made available in electronic form. The holder of a mortgage note can be registered and updated online with both parties' consent, without presenting the document to the registration authority.

The aims of the amendment are to increase electronic contracting, improve the effectiveness and decrease the cost of registry keeping and all real estate-related activities. In the case of mortgage notes, the amendment should decrease the storage costs of the physical documents and the risk of losing such documents. The amendment will also expedite the process of security transfers. For the time being, it will remain possible to use a notary public and conclude the purchase in writing, although the legislative materials of the government bill state that options may later be limited to electronic only. Similarly, mortgage notes are still available as paper documents.

In practice, the traditional method, in which the seller, purchaser and notary public are present at the same time and the sale and purchase agreement is concluded in writing, will remain the most common way for real estate conveyance, at least in large real estate transactions. Although the notary public fee is not applicable (and generally, the notary public fee represented a very minor part of transaction costs), there will be a service charge for a sale and purchase through the electronic service. With regard to mortgage notes, the popularity of the electronic form depends on the major Finnish banks deciding to convert the existing mortgage notes in their possession into electronic mortgage notes, and also requiring the use of electronic mortgage notes when providing financing in real estate transactions. The implementation of the new mortgage system creates a clear possibility for banks to facilitate the management of mortgage notes and also to save costs. However, it is anticipated that foreign banks will continue to prefer physical mortgage notes over electronic mortgage notes.

The Finnish Supreme Administrative Court recently handed out two noteworthy decisions. In decision KHO:2013:43, the Court defined the rights granted by a joint possession agreement on real estate. A joint possession agreement outlines the co-owners' rights in respect of a piece of real estate, such as the areas they control and distribution of costs. In this case, the municipal authority had rejected one co-owner's application for a building permit on the grounds that the authorisation of the other co-owners had not been provided with the application. The agreement between the parties defined the areas controlled by each of the co-owners, and how the permitted building right was distributed between them. The municipal authority ruled that, after the co-owners had withdrawn their authorisation from the permit process, the building permit could not be granted. The administrative court agreed with the municipal authority and dismissed the application. The Supreme Administrative Court reversed the decision, outlining that, considering the contents of the agreement and its purpose, the withdrawal of authorisation did not prevent the co-owner from applying for a building permit. Previously, it was unclear whether the rights defined in the joint possession agreement fulfilled criteria required for the granting of a building permit. The outcome of the decision is that a properly registered joint possession agreement may, depending on the rights transferred in the agreement, be comparable to the ownership of the defined area of the real property. Previously, a co-owner's written authorisation was usually required by the authorities in this respect. This may – especially from the perspective of property developers and construction companies – have an impact on the viability of co-owned real properties, making the permit processes more manageable and increasing legal certainty.

In decision KHO:2013:151, the Court held that three separate purchases of a specified share of real property, concluded at the same time but with three different sellers, should be construed as a single sale for the purpose of the pre-emption rights of the municipality, even if none of the purchases separately exceeded the relevant statutory area threshold. This reinforces the legal practice of a reasonably broad interpretation of pre-emption rights.

A newly passed law will reorganise the National Land Survey of Finland into a single nationwide authority instead of separate local offices with local jurisdiction. The local offices will no longer be survey offices with exclusive geographic jurisdiction, but local customer service counters whose jurisdiction will not be limited to specific Finnish territories. In addition to removing jurisdiction problems, this should allow better distribution of resources while simplifying and expediting the registration processes and ensuring consistent registration practice throughout Finland. The reorganisation took effect on 1 January 2014.

VIII OUTLOOK AND CONCLUSIONS

There are strong indications that in 2014, the availability of bank financing will again be the main driver of the development of the Finnish transaction market. The European sovereign debt crisis will have an adverse impact on acquisition finance and transaction volume, but there are certain signs of slight recovery due to a partial shift in financing – from the banks' balance sheets to alternative sources of financing such as corporate bonds – and because purchasers' and vendors' price expectations have come closer together. In addition, low interest rates combined with the possible decreasing margin levels may stimulate a modest growth in transaction volume. The division of the property market, however, appears to continue: investors and financiers are likely to favour core properties with stable cash flow over non-core properties in secondary locations, but the shortage of such core properties will impede this considerably. The above-mentioned shortage as well as low yields of core properties may shift part of the demand towards non-core properties.

The government has introduced restrictions on the deductibility of interest for entities engaged in business activities. Entities engaged in activities other than business, such as ORECs or MRECs, or their HoldCos, are, in general, excluded from the scope of this limitation; however, the government will reconsider the scope at a future date and may propose further limitations. With regard to real estate tax, the government has made some proposals in its political agenda that may lead to a future tax rise.

Chapter 11

FRANCE

Pierre Gebarowski and Guillaume Rossignol[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

Under French law, there are several common types of ownership.

Full ownership is a constitutionally protected right defined as 'the right to enjoy and dispose of property in the most absolute manner, provided that no use is made of it which is prohibited by the laws and regulations'. As an absolute right, it confers on the owner the use of the asset (*usus*), the right to receive the fruits of this asset (*fructus*) and the right to dispose of it (*abusus*).

Co-ownership may refer to either *indivision* (governed by the common rules of the Civil Code) or *copropriété* (governed by the Law of 10 July 1965 and its implementing Decree of 17 March 1967). *Indivision* refers to the situation where several co-owners jointly exercise the same right of full ownership over the same property considered as a whole (and not over a distinct share of the jointly owned property). *Copropriété* refers to the situation where two or more co-owners share the ownership of a property, each enjoying full rights over the private part of the property owned by it and shared rights over the common parts of the property (e.g., entrance hall, lifts areas, etc.). *Copropriété* is generally the legal regime used for residential housing.

Division en volumes is a contractual technique that consists of dividing the ownership of a property into distinct volumetric shares on different levels that may be located either above or beneath the natural ground. These shares are three-dimensionally defined and described, and no common parts exist between them. This technique is mostly used for real estate assets featuring a complex structure and organisation, in particular when there is an overlapping of surface areas, or when there are different surface areas, each with a different use (commercial, office, retail, etc.).

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Long-term leases such as the *bail à construction* and the *bail emphytéotique* are entered into for a term between 18 and 99 years. Under these leases, the tenant is granted a right *in rem* over the tenure itself as well as the existing property or the constructions to be erected by the tenant during the course of the lease. At the end of these leases, ownership of the new constructions is, in principle, transferred to the landlord, who will also benefit from all improvements made by the tenant by way of accession, without indemnity for the latter.

ii System of registration

Real property includes land and any buildings or fixtures attached to the land, and ownership interest in them. Generally, if the same entity owns both the land and the buildings erected on it, the title is subject to one single registration, and the land and buildings are registered together. If the property is divided into units, these must be registered separately.

To be effective and enforceable against third parties, the transfer of real property ownership must be evidenced by a written deed authenticated by a French notary with a view to registering it, after its execution, with the local land registry managed by the mortgage registrar.

Note that there is no state guarantee of title, and the land registry cannot be liable for registering inaccurate information. Registration of title with the land registry by notaries allows the title holder to exercise owner's rights against third parties.

iii Choice of law

Transactions involving real estate in France are, in principle, governed by the law of the place of location of the property. All asset transactions involving a property located in France are therefore governed by French law.

II OVERVIEW OF REAL ESTATE ACTIVITY

Real estate investment is still regarded as a reliable and profitable fallback investment strategy by many investors; accordingly, French real estate investment was quite active in 2013, although the focus continues to be on prime assets and transactions in core markets, with increasing competition on these deals resulting in very challenging cap rates on trophy assets. Investors' funds and public savings are channelled into the real estate market mainly through French real estate investment trusts (REITs) and insurance companies; these were still among the biggest players in 2013 together with foreign sovereign investment funds (Qatar, Abu Dhabi, China, etc.); this is in some part because they rely less on banking financing than other investment funds.

As expected, and in spite of historically low interest rates, the introduction of the Basel III Regulation led banking institutions to apply a more selective credit policy. This encouraged insurance companies to enter the mortgage financing market and compete with banking institutions, especially for large loans as well as debt funds for more speculative deals. Pricing remains high for average deals, but competition between lenders on prime assets is becoming aggressive, also resulting in lower pricing and higher leverage for these transactions.

The fiscal reforms decided at the end of 2011, along with the first measures taken by the new government following the elections of May and June 2012, are generally seen as potential deterrents to investment in France, even though there has not been a slowdown in real estate investment activity to date.

III FOREIGN INVESTMENT

Foreign investment in France is subject to declaration obligations to the French authorities if certain conditions are met.

As a general rule, direct foreign investment is subject to mandatory declarations for statistic or administrative purposes to the French central bank or to the French Economics Ministry (or both) if the investment amounts to more than €1.5 million; however, exemptions from such declaration may apply. For this reason, the implementation of any declaration obligations must be reviewed case by case.

In terms of timing, such declarations must be made within 20 days of the date of the operation or at the date of the execution of the relevant operation depending on the kind of declaration (i.e., statistical or administrative). Breach of such declaration obligations is subject to criminal sanctions (including imprisonment).

By way of exception, certain real estate investments listed by decree are subject to prior administrative authorisations. These investments mainly concern sensitive sectors, such as national defence.

Transfer or direct acquisition of real estate, acquisition or purchase of a stake in French real estate funds (OPCIs) or in any special purpose vehicles (SPVs) made by foreign investors may also be subject to mandatory declaration.

From a tax perspective, foreign legal entities (but not individuals) that hold, directly or indirectly, real estate located in France, must pay an annual tax equal to 3 per cent of its fair market value, regardless of any acquisition debt. Such entities can, however, be exempt from this tax by complying with certain filing obligations required by the French tax authorities.

The following are automatically exempt from this tax:

a international organisations, sovereign states or one of their institutions, including legal entities, bodies, trusts or equivalent institutions that they control and have a majority interest in;

b entities whose French assets do not comprise mainly real estate;

c entities whose shares are significantly and regularly exchanged on a regulated stock exchange, including any subsidiary entities whose total shares they hold directly or indirectly; and

d entities with their registered office located in France, in an EU Member State or in a country or territory that has concluded a reciprocal tax or mutual assistance treaty with France and which:
- have a share in properties located in France representing less than €100,000 or 5 per cent of the property's market value;
- are established to manage pension funds (including partnerships between entities), or as charities with acknowledged public utility or a not-for-profit purpose, if their activity or financing justifies the ownership of the real estate assets or rights; or

- are incorporated as an OPCI (with certain conditions), or a form regulated by similar rules in the country in which they are incorporated.

IV STRUCTURING THE INVESTMENT

Real estate investments are usually made through SPVs incorporated as French companies, listed property investment companies (SIICs) or OPCIs.

i SPVs

SPVs can either be tax vehicles subject to corporation tax or transparent tax vehicles, in which case profits are determined at company level but will be taxed in the hands of shareholders.

ii SIICs

The SIC regime (largely inspired by the US REIT regulation) applies to real estate investment companies that:

a have a minimum share capital of €15 million;
b are listed on a French regulated market;
c have a minimum floating shareholding of 15 per cent at the date of the election for the SIIC regime (floating shareholdings are those held directly or indirectly by legal or natural persons with less than 2 per cent of the total share capital and voting rights); and
d do not have more than 60 per cent of their share capital or voting rights held directly or indirectly by one shareholder (or by different shareholders in a joint control situation) unless the shareholders are also SIIC-qualifying companies.

The SIIC regime also applies to SIIC subsidiaries subject to corporation tax that are at least 95 per cent held, directly or indirectly, by the SIIC and have the same corporate purpose.

The SIIC regime provides a full exemption for corporation tax purposes on profits deriving from real estate investments (rents and capital gains), provided that certain distribution obligations are fulfilled (95 per cent of net rents, 60 per cent of capital gains and 100 per cent of dividends received from SIIC subsidiaries). Tax is therefore passed on to investors, who are subject to:

a French personal or corporation tax if they are French residents (in this case, the distribution cannot benefit from the parent subsidiary regime if the amounts distributed correspond to tax-exempt profits; or
b French withholding tax if they reside abroad.

Distributions paid out of tax-exempt profits are subject to:

a a 20 per cent levy if they are paid to corporate shareholders that hold, directly or indirectly, more than 10 per cent of the dividend rights at the time of the distribution, and that are not subject to corporation tax or to an equivalent tax on the distributions received.

b a 3 per cent contribution on dividends, unless those dividends are paid to a SIIC by one of its subsidiaries that has also elected for the SIIC regime, or if those dividends are distributed by a SIIC company to fulfil its distribution obligations.

Companies electing the SIIC regime are entitled to step up the tax basis of their eligible assets at a reduced cost (19 per cent instead of 33.33 per cent) payable in four years.

iii OPCIs[2]

OPCIs are fully exempt from corporation tax and from the 3 per cent contribution on dividends, but are subject to distribution obligations (85 per cent of net rents, 50 per cent of capital gains and 100 per cent of dividends received from subsidiaries exempt from corporation tax on their real estate activities). Their main business purpose must be direct or indirect investment in real estate assets with a view to carrying out rental activities.

OPCI subsidiaries that are subject to corporation tax can elect the application of the SIIC regime described above if they are at least 95 per cent held, directly or indirectly, by the OPCI and have the same corporate purpose.

The creation of an OPCI is subject to the prior approval of the French Stock Exchange Commission.

V REAL ESTATE OWNERSHIP

i Planning

In France, the rules applying to the construction of a building or to the completion of a development operation are set at both the national and local level.

At the national level, the French town planning code applies, encompassing national town planning rules (which apply in the absence of municipal town planning rules) and rules applying in specific areas such as sea and lake areas and mountain areas.

At the local level, land use plans (PLUs) apply. A PLU is usually adopted at the city level by the relevant municipal council, but the latest legal developments favour its establishment at the inter-communal level. The PLU sets the specific rules applying in the different zones (i.e., urban zones, agricultural zones, natural zones and zones to be opened to urbanisation) of the territory it covers regarding the type and nature of admitted constructions, service road conditions and minimum surface area for a plot of land to be constructed, setback requirements, site coverage ratio and floor area ratio, maximum height and design of the buildings, requirements in terms of creation of parking spaces and green surface areas.

A project's compliance with these rules is assessed by the relevant authority for the building permit.

2 In particular, OPCIs with simplified rules.

ii Environment

Legal requirements concerning classified facilities

A real estate asset (such as a warehouse) may qualify as a classified facility or may be served by a piece of equipment (such as an air conditioning system serving an office building) qualifying as a classified facility.

Classified facilities are defined and listed in an official nomenclature that indicates a classification level, according to the potential risks to the environment.[3] Classified facilities are subject to a specific regulation codified in the new French Environmental Code.[4]

To validly operate such facility and depending on its classification level, the proposed operator must either file a declaration or a registration or apply for authorisation, which is acknowledged or granted by the local authority. Moreover, the seller of a property where a classified facility is or has been operated must inform the purchaser of any danger or nuisance resulting from previous operations on site, to the extent that he or she is aware thereof. If the seller fails to provide this information, the purchaser can rescind the sale or obtain the reimbursement of a part of the purchase price. The purchaser may also require that the site be cleaned up at the seller's expense, when such cost remains commensurate with the purchase price.

If a classified facility is operated without the above-mentioned required declaration, registration or authorisation, or if the operator does not comply with applicable rules and regulations, such operator may be held liable from an administrative, civil or criminal standpoint.

When a classified facility ceases its activities, the local authority orders the last operator to conduct environmental investigations and will issue an administrative order to clean up the site according to the results of these investigations.

It should be noted that when pollution is discovered on a site, the administration will require the last registered operator of the site to clean it up or, if this pollution is generated by a neighbouring facility, the last registered operator thereof.

If pollution coming from the site's underlying ground generates damages to a third party, such third party would be entitled to initiate a civil action against the current operator or the property's owner (or both) acting as a *gardien de la pollution*.[5] The property's owner or current operator will nevertheless be in a position to initiate a civil action against the person or operator actually liable for the pollution if identified.

Legal requirements concerning hazardous waste handling

Contrary to the classified facilities legislation that targets the operator of the facilities, the legislation set out in the Environmental Code[6] governing the holding and handling of hazardous waste may impose obligations upon the owner of a property.

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3 This encompasses a wide variety of equipment or premises ranging from air-conditioning systems to warehouses or factories whose operation involves handling hazardous substances.

4 Sections L511-1 et seq.

5 Literally, 'keeper of the pollution'.

6 Sections L541-1 et seq.

Especially where the owner of land carries out the construction of a building requiring prior excavation of polluted soil, the owner is liable for proper handling of excavated soil that should then be directed to a special storage centre designed for the treatment of polluted soil (the selection of the storage centre depending on the level of pollution detected in the handled waste).

iii Tax

The sales of development lands (i.e., lands on which the buyer is allowed to erect new buildings under urban planning) and new buildings (i.e., if the sale occurs within five years of completion of the buildings) fall within the scope of VAT (the current rate is 20 per cent since 1 January 2014 (19.6 per cent before 1 January 2014)).

Sales of lands that cannot be considered as development lands and of old buildings are exempt from VAT; however, the seller can always choose to elect to pay VAT.

The sales of buildings also trigger a transfer tax amounting to 5.09 per cent (territorial authorities are allowed to increase this rate up to 5.81 per cent for sales realised from 1 March 2014) of the value of the asset. This rate can in particular be reduced to:

a 0.715 per cent if the sale concerns new buildings or development lands;

b 0.715 per cent if the buyer undertakes to resell the asset within five years of the acquisition; or

c €125 if the buyer undertakes to erect or complete new buildings within four years of the completion of the sale.

In any case, a fee amounting to 0.1 per cent of the value of the asset will be due, and the notary will ask for a 0.825 per cent fee (which can be negotiated if it exceeds €80,000).

Sales of shares in real estate companies (which assets mainly consist of French real estate) are subject to a 5 per cent transfer tax based on the value of the assets less the amount of debt incurred for the acquisition of the building.

iv Finance and security

The acquisition of real estate is usually secured through a mortgage, which must be granted under a notarised agreement under French law. Depending on the purpose of the transaction, this security will be in the form of a contractual mortgage or a money purchase privilege. Both securities grant the lender the right to become the owner or resell the mortgaged real estate at public auction if the borrower defaults under the financing.

As regards the income generated by the property, the rents payable to the borrower or the indemnities payable to it in relation to the holding of its real estate (such as insurance indemnities or indemnities due under the acquisition agreement of said real estate) are usually assigned by way of security or pledged in favour of the bank.

Finally, one must stress that when the borrowing entity is an SPV, lenders very often require that the shareholders of the SPV also pledge the shares they hold in the share capital of the borrower as a security.

VI LEASES OF BUSINESS PREMISES

i Scope of statutory regime

In France, leases on property used for commercial or industrial purposes are governed by specific statutory provisions (codified under Sections L145-1 to L145-60 and R145-1 to R145-33 of the Commercial Code).

In France, the principle is that the commercial lease statute mandatorily applies to all leases entered into on premises where a business is operated (commercial offices, warehouses, factory buildings, industrial premises, shops, etc.). An essential feature of French law on commercial leases is the right of the lessee to obtain renewal of the lease upon its expiry or to obtain compensation if the lessor refuses to renew.

The commercial lease statute does not apply to leases on premises used by professionals (doctors, notaries, lawyers, etc.) for professional purposes, which are subject to a specific regime; since 2008, however, it is now legally possible to subject a lease entered into with professionals to the commercial lease statute.

ii Duration

In principle, the duration of a commercial lease must be for at least nine years (subject to specific exceptions), regardless of whether the lease is concluded for the first time or is being renewed: this provision is a matter of public policy. The lessee has an option to terminate a commercial lease at the end of every three-year period. The tenant may, however, contract out of such right or on the contrary be given additional break options.

Pursuant to Section L145-12 of the Commercial Code, the duration of a renewed lease is nine years unless the parties agree, at the time of the actual renewal, upon a longer term.

iii Termination and security of tenure

In principle (and apart from specific situations, such as amicable termination or termination by court order), French commercial leases may only be terminated by a termination notice, which has to be issued by a court process server at least six months in advance (subject to local usage) and contain specific provisions.

Under French law, the lessor may always refuse to renew the lease upon expiry and terminate the lease, but in such case (as a consequence to the security of tenure) the landlord will have to pay compensation for eviction in an amount equal to the loss suffered by the tenant as a result of the lease not being renewed. Limited circumstances allow the landlord to terminate the lease upon expiry without compensation (non-performance by the lessee of its material obligations, the building posing a health hazard or safety risk, denial of the right for the lessee to benefit from commercial lease law, regaining possession of premises for residential purposes, etc.).

iv Rent review and rent indexation

Subject to several exceptions (e.g., leases with variable rents determined on the basis of a percentage of the tenant's turnover), commercial lease statute provides for a three-year review arrangement whereby each party may seek a rent review so that the rent corresponds to the rental value of the premises. In principle, the increase (or decrease) of the rent is capped by the variation of the statutory index selected by the parties, unless a change in the rental value exceeding 10 per cent and triggered by a material alteration of the local commercial conditions can be demonstrated.

The parties may agree that the rent be indexed on an annual basis, although such provisions do not override the three-year review stipulated by law. Moreover, Section L145-39 of the Commercial Code provides that any party to a commercial lease agreement may request a judicial review of the rent at the current market value of the premises provided that the commercial lease agreement provides for an indexation clause and that, as a result of the clause, the rent has increased or decreased by at least 25 per cent since its last contractual or judicial setting.

v Rent upon renewal

Pursuant to Section L145-33 of the Commercial Code, the rent of the renewed lease shall be set at the market value; however, the variation between the rent under the initial lease (whose duration is no more than nine years) and the rent under the renewed lease cannot exceed the variation of the statutory index selected by the parties over the period of the lease (unless one of the parties can provide the evidence of a significant change in one of the elements that served as the basis for the initial setting of the rent).

Pursuant to the provisions of Section L145-34 of the Commercial Code, where a commercial lease is entered into for a term of more than nine years, the rent of the renewed lease may be uncapped upon renewal and set at the rental market value.

The provisions governing the rent determination upon renewal are not mandatory and may be agreed otherwise by the parties. The provision of a variable rent (based on the tenant's turnover) is regarded as setting aside the statutory provisions

vi Assignment of a commercial lease

The basic principle under the French commercial lease statute is that the lessee may assign its lease right to the purchaser of the business operated in the rented premises. To prevent the tenant from being deprived of its option of assigning its business, any agreement that prevents the tenant from assigning the lease right to the purchaser of its business undertaking will be declared null and void; however, the initial lessee (assignor) may remain jointly and severally liable for the fulfilment of its assignee's obligations under the lease.

Pursuant to French case law, clauses providing that the assignment is subject to certain conditions (e.g., good faith of the assignee) are deemed valid, provided the various restrictions do not make it impossible in practice for the tenant to assign its business.

vii Authorised use of the premises

French commercial law does not offer the lessee any specific option to modify the leased premises without the lessor's consent. The French commercial lessee is entitled, however, under certain circumstances, to extend or change the scope of the activities it is contractually authorised to operate in the rented premises. If the landlord refuses, the lessee can apply to the courts to seek such authorisation.

VII DEVELOPMENTS IN PRACTICE

i Indexation in commercial leases

New index on commercial leases applying to offices and logistic warehouses

Commercial leases usually contain an indexation clause under which the rent is automatically reviewed and calculated every year on the basis of the variations in the Construction Cost Index (the ICC Index) or, if applicable, the Commercial Rent Index (the ILC Index), both published quarterly by the National Institute of Statistics and Economic Studies.

A new index, the Tertiary Activities Rent Index (the ILAT Index), was created on 17 May 2011. Its implementing decree was enacted on 29 December 2011 and sets out the rules for the composition and calculation of the ILAT Index, which may be used for tertiary activities other than commercial and craft activities as well as renting of office space for activities run by professionals (such as lawyers and doctors) or in logistic warehouses.

Need for clarification on rent indexation clauses

Over recent years, the application of some indexation clauses included in commercial leases has been challenged by tenants on the basis of their non-compliance with public order regulations applying to indexation clauses in general. A legal clarification of the indexation regime is expected to put an end to a situation of legal uncertainty.

To mitigate the consequences of a massive increase of the ICC index on the level of commercial rents over recent years, cap and floor limitation mechanisms have been agreed upon in commercial leases. In the absence of clear-cut case law from the Supreme Court, there is a risk that some of those mechanisms could be considered null and void and to be breaching general public order regulations on indexation.

The Paris Civil Court also handed down two contradictory decisions on 5 January 2010 and 13 January 2011 on the validity of indexation clauses allegedly contravening the provision of the Monetary and Financial Code that rules that 'any clause in a successive performance contract, including all kinds of leases and rental agreements, which provides for the application of an index variation period longer than the interval between each review, is deemed void'.

However, two much-anticipated decisions of the Paris Appellate Court rendered on 4 April 2012 have reversed the controversial decisions of the Paris Civil Court that challenged the validity of such indexation clauses, by ruling that even if the drafting of the clause was not literally compliant with the aforementioned provision of the Monetary and Financial Code, the clause should nonetheless be held valid if its implementation did not have adverse financial consequences for the tenant.

ii Possible reform of the commercial lease statutory regime

A draft bill has been under review by the Parliament since August 2013; it proposes a quite significant reform of the French commercial lease statutory regime. The main features of this proposed reform are as follows.

ICC Index no longer applicable

Under the proposed bill, the ICC Index would no longer be eligible for indexation of the rent under a commercial lease: the ILC Index (as defined above) for commercial activities, or the ILAT Index (as defined above) for tertiary or professional activities or warehouses, would still be available. The ILC Index is now seen as an index that is too versatile.

Cap of 10 per cent on rent adjustment upon renewal

The provisions governing the determination of rent adjustment upon renewal of a commercial lease would be amended to include an absolute cap that would be applicable to any renewal rent adjustment. Accordingly, the implementation of the rules governing the determination of the rent upon renewal may no longer result in an annual increase of the rent exceeding 10 per cent of the last passed rent of the renewed lease.

Mandatory limitation on rechargeable service charges

The French Civil Code provides for some rules with respect to allocation of service charges, works and repairs obligations between landlord and tenant. Such rules are applicable to all kind of leases (meaning that they are not specific to commercial leases) but are not mandatory: parties may agree otherwise on such allocation.

The draft bill (to be supplemented by a decree on this matter) proposes to list some service charges and repairs that would no longer be rechargeable to tenants. This mandatory limitation would be a revolution in the French market practice, where triple net investors' leases have been drafted and negotiated so far under the assumption that the tenants should bear all charges and repairs.

Pre-emption right on the rented premises to the tenant

The draft bill provides for a pre-emption right conferred upon the tenant under a commercial lease in the event of a sale of the rented premises. The implementation of such pre-emption right would significantly and adversely affect the liquidity of real estate assets on the French market.

The bill is still far from passing into law. However, should all or part of the proposed reform be eventually adopted, this would have a tremendous impact on the French real estate market.

iii Growing focus and attention on environmental issues

Environmental matters have become a key issue for participants in the French real estate market further to the Environment Round Table[7] forum. This forum refers to a set of political meetings that were held in France between September and October 2007, aimed at making long-term decisions in the areas of environment and sustainable development and which have given rise, over recent years, to the enactment of two pieces of legislation.

The Grenelle 1 law of 3 August 2009 provides for a comprehensive set of targets relating to building and energy, public transportation, biodiversity and agriculture,

7 Grenelle de l'environnement.

health and environmental risk prevention, waste treatment and governance (information and training). The Grenelle 2 law of 12 July 2010 on the national commitment to environment (supplementing the Grenelle 1 law) provides for actual implementation of the following objectives:

a energy performance for buildings and the harmonisation of tools in terms of urban planning;
b public transportation that is more respectful to environment while ensuring mobility needs;
c reduction of energy consumption and carbon emissions;
d biodiversity preservation;
e implementation of new green governance; and
f environmental risk monitoring, waste treatment and health preservation.

The Grenelle 2 law contains or consolidates numerous provisions that affect real estate transactions. In particular, it provides for the following:

a sellers must now provide certain information regarding, *inter alia*, mandatory communication of an energy consumption diagnosis for the sale of any real estate asset;
b landlords must convey certain information to the tenant regarding risks of ground pollution, energy consumption diagnosis and a natural and technological risk statement for any real estate asset leased; and
c energy efficiency works must now be carried out for buildings used for tertiary activities or public services within eight years of 1 January 2012.

The decree of 30 December 2011, supplementing the Grenelle 2 law, also aimed at creating a green lease legal regime. It introduces an obligation to attach an environmental annex to a lease with respect to office or commercial space of more than 2,000 square metres. Such annex must contain information regarding the features of the facilities and systems of the building and leased premises, their actual water and energy consumption and the quantity of waste generated. It must also mention each party's obligation to undertake to complete a programme of actions with a view to improving the energy and environmental performance of the building and leased premises.

More generally, green labels and certifications (HQE, BBC, BREAM standards, etc.) have become a pre-eminent valuation criterion of real estate assets. This is reflected in the market practices. Among other examples, the granting of labels and other environmental certifications is now viewed, in real estate development projects, as fully incorporated in the definition and scope of the building to be erected. It is now also market practice that the price is not paid in full by the purchaser until the developer has obtained these labels and environmental certifications.

iv New mortgage financing practice and issues

The entry of insurance companies and debt funds into the mortgage financing markets brought about some changes in the practice of mortgage financing for either legal or financial considerations.

The regulatory law for insurance gives insurance companies the benefit of an exemption to the banking monopoly, allowing them to provide, under certain leverage conditions, mortgage financings. However, this exemption does not confer the status of banking institutions on the insurance companies, with the result that they cannot be granted a Dailly law security assignment of receivables against the borrower; the Dailly law assignment is one of the key security interests in real estate financing. The insurance companies can only be granted a pledge of receivables, which is ultimately regarded as a less robust security than a Dailly law assignment. This may lead to complicated negotiations in the case of a mixed pool of lenders (with banks eligible to receive Dailly law assignments and insurance companies not). Debt funds that do not qualify as banking institutions under French law face the same issue.

The insurance company assault on the mortgage financing market has also favoured the development of a hitherto unusual practice in real estate financing: financing by bonds issuance. The financing providers are buying bonds issued by the borrower instead of providing straightforward loans. This has an impact on the investment structuring of the borrowers, as some corporate forms of companies (French SCI, SNC and, to some extent, SARL) are not eligible for bonds issuance. This also offers the real estate debt market the prospect of flexibility to structure real estate debt between senior lenders and mezzanine lenders.

Financial considerations also weigh on the negotiations of the financial terms of financings. As insurance companies regard real estate financing as an alternative to investment of public savings in long-term fixed-income products, they can provide financings of longer duration (10 years) than the banks, but they impose tougher early repayment clauses on borrowers (computing break-costs until final maturity rather than the end of the current interest period).

VIII OUTLOOK AND CONCLUSIONS

It is anticipated that the insurance companies and foreign sovereign investment funds will continue to grow their market share in real estate investment and financing, bringing changes to practices in structuring, and in financing negotiations. This new offer may help provide refinancing for many highly leveraged investments, whose financing will mature during the next year.

Insurance companies are, however, as selective in providing financing as banks, and some investors are heading towards an inevitable restructuring of their loans. This may be approached through soft negotiations with lenders with the help of a court-appointed *ad hoc* agent, or investors may choose to rely on the constraining safeguard proceedings resulting from the combined application of the statutory law reform enacted in 2005 and its construction by French courts.[8] The latter option allows French SPVs owning real estate to apply for court protection against creditors at an early stage when they anticipate refinancing difficulties – even quite a long time before they become actually unable to repay their debts.

8 See the *Coeur Défense* case. Cass. com., 8 March 2011, No. 10-13. 988.

From a tax standpoint, several measures have been or could be considered. First, the taxable basis has been widened during the past two years (e.g., thin capitalisation rules have been modified and now include financing granted by third parties when they are secured by a related party; the use of tax losses is now limited). It is also likely that the SIIC and OPCI regime will be modified in the future. In particular, some parliamentarians tried to modify the SIIC regime by creating a 33.33 per cent levy on every dividend distributed by a SIIC to a legal entity and deriving from real estate investment income; however, this proposal has not been enacted, and there is no clear indication as to whether it ever will be.

Chapter 12

GERMANY

Ingo Klöcker[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

Under German law, several types of ownership of real estate exist. The most important type is absolute ownership, sometimes also referred to as freehold, which extends, by operation of law, to land and to any buildings or other structures erected on and firmly affixed to the land, as well as to (immoveable) fixtures and fittings and (moveable) appurtenances.

A further type of ownership is the hereditary building right, sometimes also referred to as a perpetual lease or leasehold. This entitles the owner of a hereditary building right to erect and own a building or other structure on or under a certain piece of land owned by a third party against payment of a fee, most often paid in regular instalments over the term of the hereditary building right. Historically, the term of a hereditary building right was commonly 99 years, but it can be agreed for any other period; nowadays it is usually shorter. The hereditary building right can be sold and transferred, but the contract establishing it will very often provide for a consent requirement and a pre-emptive right in the landlord's favour. Upon expiry of the hereditary building right, the building will be transferred back to the landowner against payment of compensation to the right holder, which is either pre-agreed or corresponds to the current market value of the building.

Real property can also be co-owned in two ways. The co-owners may hold an agreed co-ownership share in the land and building, or – more commonly, pursuant to the provisions of the Condominium Act – they may hold co-ownership shares in the land and structural parts of the building, and enjoy exclusive ownership or exclusive

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rights of use to the interior parts of residential apartments, or offices or other commercial space. The latter structure is commonly used for development projects to be marketed to a number of investors after, or if possible during, the construction period.

Real property or a hereditary building right can be made subject to *in rem* easements or encumbrances in favour of a third party or the owner from time to time of another property, such as rights of way in favour of an adjacent property, or the right of a public utility company regarding electric lines or water pipes, etc.

ii System of registration

Cadastral offices, operated by local municipalities, keep property cadastres in which any piece of land within the boundaries of the municipality is registered according to *situs*, use and size, and cadastral maps depicting *situs*, size and shape of such piece of property. As a result, any piece of land can be clearly identified.

With certain exceptions for properties owned by public or quasi-public entities, any piece of land is also registered in land registers that are kept by land registry offices at the local courts. The land register contains information about the identity of the property (in accordance with that in the property cadastres), the owner, *in rem* encumbrances, and mortgages and land charges. The system is highly developed and extremely reliable and has, over the past few years, been transferred from paper form into electronic form. It can be reasonably assumed that the contents of the registrations are correct, and so one can in good faith acquire the property or rights in the property as registered. As a result, title guarantee or title insurance are alien to German law. Priority of title to and rights in a property with regard to third parties is determined in accordance with the point in time at which a filing for registration is received by the land registry office. Anybody who can establish a legitimate interest can inspect and obtain a copy of the land register and of documents filed with the land registry office.

iii Choice of law

German law makes a strict distinction between the obligatory contract in which the parties agree on the obligation to transfer title to an asset against consideration in accordance with certain terms as agreed in the contract, and the contractual agreement on the transfer of title to the asset as such. While contract parties are free in their choice of the law applicable to the obligatory contract (including representations and warranties and other covenants), the agreement on transfer of title as such of a real property situated in Germany is, in accordance with the principle of *lex rei sitae*, mandatorily governed by German law.

Contracts for the sale and purchase of real estate, or for the creation of a land charge to finance a purchase of real estate, must be notarised and are very technical instruments with complicated provisions specific to German law; the notary plays an important role in the implementation and registration of the transaction. For this reason, it is well-established practice to choose German law and have the documentation notarised by a German notary.

II OVERVIEW OF REAL ESTATE ACTIVITY

In 2013, the German real estate market continued to be boosted by the combination of the low interest rate policy of the ECB and the volatility of financial markets, generally increasing the appetite of investors for investments in safe, stable assets such as real estate. The market has seen an increasing number of transactions with larger volumes adding up to a total transaction volume of approximately €30 billion for commercial and €12 billion for residential properties. More than half of the volume relates to the metropolitan areas of Berlin, Düsseldorf, Frankfurt, Hamburg and Munich.

The liquidation of open-ended real estate funds that do not have sufficient liquidity to meet redemption requests continues to be a source of mergers and acquisitions activity. Pension funds, (listed) real estate corporations, foreign real estate investment trusts (REITs) and sovereign investment offices, private investors, family offices and insurance companies, are important buyers. While 70 per cent of the buyers were domestic, the remaining 30 per cent of buyers came from abroad, in particular from the United States, Canada and the United Kingdom, as well as the Far East.

Residential portfolios, shopping centres and other retail properties, and core office properties, have been the focus of investor interest and this will continue, with investors being selective about location, building quality and long-term steady cash flows. Prices are rising.

In 2013, Germany has also seen a few IPOs of real estate companies active in the residential sector that, however, did not exactly meet initial expectations, as well as several takeovers of listed and privately held real estate companies in the residential sector.

III FOREIGN INVESTMENT

No restrictions apply to the acquisition and holding of real estate by foreign investors. This applies to direct acquisitions by foreign individuals or legal entities, as well as to indirect acquisitions through the formation by foreign individuals or legal entities of purchasing vehicles in the form of legal entities governed by German law.

Further, there are no restrictions on the free transferability of funds in relation to providing equity or debt for the acquisition of real estate or repatriation of profits. Foreign investors are naturally subject to generally applicable money laundering laws. Cross-border money transfers must be reported under the provisions of the Foreign Trade Act and Foreign Trade Regulations for statistical purposes only.

IV STRUCTURING THE INVESTMENT

Depending on whether the property is owned by an individual or a holding vehicle in the form of a legal entity, the acquisition of real estate can be structured as an asset deal, acquiring the asset from the individual or the holding vehicle, or as a share deal, acquiring the shares in the holding vehicle from the shareholders. As the acquisition of 95 per cent or more of the shares in a legal entity that owns German-*situs* property triggers real estate transfer tax (RETT), structures may be considered under which the seller retains or, under certain circumstances, a third party acquires, for the time being, more than 5 per cent of the shareholding in the holding vehicle. Because acquisition structures have, in the past, been widely used by investors to acquire economic interests in real estate holding vehicles in excess of 95 per cent without triggering RETT (RETT blocker structures), anti-RETT blocker legislation was adopted in 2013. Pursuant to this anti-RETT blocker legislation, RETT would be triggered in a share deal if a purchaser acquires, directly or indirectly, an economic interest of 95 per cent or more in a real estate holding company. Since, for the time being, only draft guidance has been published by the tax authorities, the newly adopted anti-RETT blocker legislation still poses a number of questions (in particular as to its scope where an investor only acquires a contractual participation in a holding vehicle; for example, a silent participation instead of shares), careful tax planning should be applied in order to not trigger RETT upon the acquisition of an interest in a holding vehicle.

In practice, share deals are usually carried out for the acquisition of large residential portfolios when a large number of units is in the hands of one or several holding companies, or in the case of secondary transactions involving portfolios of commercial property when the buildings are already held by special purpose holding vehicles.

On the buyer's side, a foreign investor can make the acquisition either directly (as an individual or existing legal entity) or through a foreign or German acquisition vehicle.

If a German property is owned and let by a foreign investor (or a foreign acquisition vehicle), the rental income is subject to German – individual or corporate – income tax, but no trade tax applies if no German permanent establishment exists (note that the property as such does not constitute a permanent establishment).

If the foreign investor wishes to create an acquisition vehicle governed by German law (which is often the case if the investor is a foreign investment fund), the full range of legal forms of legal entities under German law is available, and the issues of limitation of liability to the acquisition vehicle and tax treatment of the acquisition vehicle and the investors will decide which form of legal entity is chosen.

One option is to incorporate the acquisition vehicle in the form of a stock corporation (AG) or limited liability company (GmbH), which provides for full limitation of liability. The AG and the GmbH have, however, the disadvantages of not being transparent for income tax purposes and, by virtue of legal form, of being in principle subject to trade tax. Profit repatriations from such corporations are generally subject to German withholding tax (certain relief may be available if further requirements are met).

The civil law partnership (GbR) and the limited partnership (KG) have the advantage of being transparent for income tax purposes, and profit repatriations are *per se* not subject to withholding tax. The GbR, however, has the disadvantage of full liability for all of its partners. Because in a limited partnership only the general partner of the limited partnership is fully liable, the legal form of choice is a combination of both elements: a limited partnership where the general partner (entrusted with the functions of unlimited liability and managing the business of the KG) is a company with limited liability.

As, however, a limited partnership whose general partner is an AG or GmbH, which manages the business of the limited partnership, is by virtue of legal form – like the AG or the GmbH – subject to trade tax, structures are used to avoid or reduce the trade tax liability. Under one of these, for example, the general partner of a KG is a non-German entity such as a SARL under Luxembourg law so that the vehicle can argue that it does not maintain a permanent German establishment. Alternatively, the function of unlimited liability and authority to manage the business can be separated so that one of the limited partners (which can be a foreign entity with limited liability) is entrusted with the management function, and in this case the vehicle would claim that it does not *per se* derive income from trade or business that is subject to trade tax. Finally, if a German tax-resident acquisition vehicle derives income from trade or business solely because of its legal form, but in fact generates no income other than rental income from its property, trade tax may be avoided by properly structuring the leases. All of these structures require careful planning.

Only rental income from letting of land and buildings is exempt from trade tax. The letting of office or other commercial space often includes fixtures and fittings or appurtenances that may qualify as business equipment of the tenant; the rental income relating to business equipment is not exempt from trade tax and may render the rental income from the letting of the space subject to trade tax as well. It is, therefore, common practice to use a separate vehicle for the acquisition and subsequent letting of business equipment. As this rental income is subject to trade tax in any case, a GmbH is most often used for this purpose.

Predominantly, real estate investments are made directly. In addition to this a number of German (listed) real estate holding companies make indirect investments in different types of property (office, other commercial, residential, student homes, etc.) by buying up shares in trade sales or in the market. Following enactment of specific legislation in 2007, real estate investments can also be made in or through listed stock corporations qualifying as tax-transparent REITs; with only a few established, however, REITs have not yet gained major significance. Finally, investments can also be made in open-ended or closed-end funds.

V REAL ESTATE OWNERSHIP

i Planning

The legal framework for planning and zoning is essentially set out in the Federal Building Act, the Federal Building Use Regulations and state building regulations, which are enacted by the individual states.

Planning and zoning is usually based on a large-scale regional plan for the use of land, which the competent municipality then specifies in greater detail for the particular areas within that municipality. The planning process will involve extensive consultation with all other competent authorities, such as environment, safety, water, nature or monument conservation, etc., and participation from the general public. In the context of the planning process, the municipality can implement restrictions on development and change of use. Municipalities also enjoy a statutory pre-emptive right applicable to any sale of land that they can exercise to protect certain planning requirements; in practice, however, this right is very rarely exercised.

Any individual building project requires a building permit to be issued by the competent municipality.

ii Environment

Under public law, if contamination of a property presents a danger to its neighbourhood or public health, the competent authority may issue a clean-up order addressed to the current owner of a property, any previous owner thereof, any party holding actual possession of the property or the party actually responsible for the contamination. Usually, the authorities will select the party that it can most easily force to undertake the necessary clean-up measures, which is normally the present owner or tenant of the property. Along with public law liability, there is civil law liability for cleanup or damages with regard to neighbours or other third parties affected by the contamination.

Environmental issues, therefore, are an important consideration in the due diligence of a real estate transaction, and in the representations and warranties, indemnity provisions or other covenants of a real property-related sale and purchase agreement.

iii Tax

Any sale and comparable conveyance of real estate is subject to RETT. If the real estate is held by a legal entity, the sale of 95 per cent or more of the shares in such legal entity is likewise subject to RETT (see Section IV, *supra*). The RETT tax rates differ from state to state, from 3.5 per cent to 6.5 per cent of the purchase price, although the trend is towards 5 per cent or more in all German states.

In addition, fees for the notarisation of the sale and purchase agreement, and land charges required for the financing, will accrue, as will registration fees for the land registry office for the registration of the priority notice securing transfer of title, the transfer of title, any land charges and the deregistration of existing land charges. Such fees are fixed by law and amount to around 0.5 per cent of the transaction value.

Generally, the sale and letting of real property is not subject to value added tax (VAT); however, under certain circumstances it is possible to opt for its application at the normal rate of 19 per cent. The seller of a property that has opted for VAT in the past will want to sell the property subject to it; otherwise the seller may be required to repay previously deducted input VAT to the tax office. The purchaser will have to pay the VAT in addition to the purchase price (reverse charge). Lettings can only be made subject to it if and to the extent that the tenants are enterprises within the meaning of the VAT Act and render VAT-able supplies or services (see Section VI.iv, *infra*), that is, use the premises for a business involving the delivery of goods and services subject to VAT. The issue of whether an input VAT deduction has been applied in the past should be carefully addressed in the due diligence procedure, particularly when acquiring multi-tenant commercial buildings, as the seller may have let space to non-professionals or professionals who render VAT-exempt services (such as banks, doctors, etc.) in the past, or the purchaser may want to do so in the future. As a result of such changes in circumstances, the purchaser may be required to repay input VAT to the tax office.

Real estate is subject to real property tax, which is a municipal tax and is presently calculated on the basis of certain tax values. Legislative activity is under way to change the tax base from the tax value to the (higher) market value of the property.

iv Finance and security

Real estate transactions will usually be financed by one or several banks, or other providers of debt financing such as insurance companies. Security can be created over a property, a hereditary building right and a co-ownership share or, in the event of a share transaction, by a pledge or security transfer of the shares of the holding company to be acquired. The two types of security are the mortgage (which is not used in practice as its existence and amount is accessory to the existence and amount of the secured obligations) and the commonly used (non-accessory) land charge. Senior and junior debt financing can be secured with different ranking. Land charges are registered in the land register and, if no other agreement is made, the time of receipt by the land registry office of the filing for registration will determine the ranking of the land charge with regard to all other registered rights.

VI LEASES OF BUSINESS PREMISES

Leases of business premises usually contain provisions concerning the following:

i Use and public permits

The intended use by the tenant of the premises is usually precisely defined. Any change of use will be forbidden or subject to the consent of the landlord. The landlord usually does not guarantee that the premises are fit for the intended use by the tenant, and the tenant is responsible for any public permits required for the conduct of its business on the premises.

ii Term and termination

Leases are generally for fixed periods (five, 10 or 15 years) with options in favour of the tenant (and rarely the landlord) to extend the term for consecutive periods (often one or several five-year periods). Another common feature is to provide that, upon expiry of the agreed term, the contract extends for consecutive periods (of one year) if not terminated with a certain termination period. A lease for a fixed term exceeding one year must be in writing. Failing compliance with this requirement, the contract can be terminated in compliance with statutory termination periods. This is a critical issue with many pitfalls, and requires careful attention in the due diligence of multi-tenant commercial real estate (see Section VII.iv, *infra*).

iii Rent and service charges

Rent is usually linked to inflation by way of an index clause. Depending on the negotiating power of the tenant, the trigger for the adjustment may be high and inflation may not be applied 1:1. Rent reviews are only very rarely agreed and, if so, probably only to apply at the time of the exercise of an option for an extension at the end of the fixed term of the lease. It is usually agreed that the tenant is responsible for any service charges in the broadest sense.

iv VAT

If the owner has opted for VAT, it will be charged in addition to the rent. The owner will only be entitled to opt for VAT and to deduct input VAT if and to the extent that the tenant is an enterprise within the meaning of the VAT Act and renders VAT-able supplies or services. This requirement must be carefully addressed in the due diligence procedure for the purchase of commercial properties (see Section V.iii, *supra*).

v Maintenance and repair, insurance

Different types of agreement can be found in practice with either the landlord or the tenant being entirely responsible for the maintenance and repair of the premises (including the structure of the building), or different levels of allocation of responsibility in between. Shifting of responsibility to the tenant normally correlates with lower rent-level agreements. Insurance is usually taken out by the landlord, but is paid for as a service charge by the tenant.

vi Business mix, non-compete protection

In multi-tenant office buildings or shopping centres, the landlord may wish to achieve and protect a certain business mix. Tenants may wish to prevent other parts of the premises being let to competitors.

vii Signage

Tenants may wish to put up prominent signage, whereas the landlord may wish to maintain a uniform appearance to the property.

viii Early termination

Early termination is a statutory right if there is cause. Usually, certain events or circumstances will be defined as constituting cause, particularly in the context of non-payment of rent or a deterioration of the financial situation of the tenant, as the landlord cannot terminate the lease early once a petition for the opening of insolvency proceedings has been filed.

ix Subletting, transfer of the lease

Subletting will normally require the consent of the landlord (not to be unreasonably withheld). Transfer of the lease by the tenant is not possible, but tenants may wish to be allowed to transfer the lease within their group of companies or as a result of a corporate reorganisation.

x Change of control

The landlord may wish to be protected against a change of control in the person of the tenant by, for example, providing for an approval requirement or a right of early termination.

VII DEVELOPMENTS IN PRACTICE

i Implementation of the Alternative Investment Funds Managers Directive (the AIFMD) into German law

Effective 22 July 2013, Germany has implemented the AIFMD into German law. The cornerstone of the implementing law is the new German Capital Investment Code (the KAGB). In line with the AIFMD, the KAGB takes an all-encompassing approach and regulates all types of investment funds, including, for the first time, closed-ended investment funds. The regulation entails a licence requirement for managers of investment funds, requirements as to the eligibility and acting of depositaries and product regulation (requirements as to the permitted legal form of investment funds and limitations as to the investment policy).

ii Open-ended real estate funds

The KAGB confirms the changes to the legal regime applicable to open-ended public real estate funds that had already been introduced by the Investor Protection and Functionality Improvement Act in 2011. The Act was a reaction to increasing liquidity problems among open-ended real estate funds, which forced a substantial number of funds to close down temporarily and eventually go into final liquidation. Most importantly to investors, the Act provides for a lock-up provision prohibiting investors from redeeming units in an open-ended public real estate investment fund for a period of at least 24 months. Further, investors are only entitled to redemptions of fund units once a year. The exemption under the Act allowing investors to redeem units in an amount of up to €30,000 per calendar half-year has been repealed by the KAGB. The KAGB has, in addition, replaced the provisions dealing with the expert committee responsible for the valuation of the properties held in the fund. Instead, and in line with the AIFMD, the KAGB requires that an independent expert or, if the previously determined value of the property exceeds €50 million, two independent experts (which must also be independent from each other) must value the property. In addition, in the case of an acquisition of a property, one or two experts, as the case may be, who are different from the experts that are responsible for the regular valuation, must value the property proposed to be acquired. Further, in the event of insufficient liquidity to meet redemption requests, the fund must suspend the redemption of fund units. If the suspension lasts for longer than 30 months and the fund still lacks sufficient liquidity to satisfy redemption requests, it must be wound up. To enable it to meet redemption requests, the fund is required to maintain liquidity in an amount of 5 per cent of its net asset value.

The above-described restrictions do not apply to special open-ended real estate investment funds, which are only open to institutional investors. The only mandatory restrictions applicable are a limitation of leverage of up to 50 per cent of the value of the real estate assets held in the fund, and a prohibition to invest more than 20 per cent of the fund's assets in private equity (excluding real estate companies).

iii Closed-end funds

The implementation of the AIFMD in Germany has brought drastic changes to the legal regime applicable to closed-ended real estate investment funds. The KAGB subjects public and special closed-ended real estate funds to a regulatory regime broadly comparable to the one applicable to open-ended real estate funds. Hence, the fund rules for public closed-ended real estate investment funds must be approved by the German Federal Financial Services Authority (BaFin). Closed-ended investment funds may only be established in the legal form of an investment limited partnership or an investment stock corporation with fixed capital. Public closed-ended real estate investment funds may only take up leverage of up to 60 per cent of the gross value of the fund. If the fund is not risk diversified (which is deemed to exist if it holds less than three properties, unless the risk diversification is commercially present with a view of the type of property) it may only be acquired by investors committing to invest at least €20,000 and passing a suitability test.

The above-described investment limitations do not apply to a special closed-ended real estate investment fund. However, for both special and public real estate investment funds, a sales prospectus and key information document must be prepared and submitted to BaFin in order to obtain approval for the marketing of the shares.

iv Civil law partnership

A widely used form of structuring investments in real estate by several investors has been the civil law partnership (GbR). It is expected that its significance will decrease, as it is no longer a permitted legal form for a closed-ended investment fund within the meaning of the KAGB. It will remain important for use by family offices and similar privately organised groups of investors, as investment vehicles set up for such predetermined groups do not fall under the scope of the KAGB.

Since the civil law partnership is not registered in any public register, the partners can only be identified from the GbR constitutional documents and through the partnership's authorised representatives. In a recent decision, the Federal Supreme Court declared that if the partners state in a real estate sale and purchase agreement that they are in fact all partners of, and are authorised to represent, the partnership, then the land registry is not required or entitled to request further evidence as to the existence, identity and authority of representation of the partnership. The GbR, therefore, should now be entitled to be owner of rights and obligations, be party to legal proceedings and be registered in the land register.

v Written form requirement for tenancy agreements

A tenancy agreement for a fixed period exceeding one year must be executed in written form. If the form requirement is not met, the tenancy agreement can be terminated in compliance with statutory termination periods. Past court decisions on this requirement have addressed the following issues: completeness of the documentation, the period between signatures of the parties, later amendments of the contract, and (in two recent decisions) the requirement that the documentation show whether all members of a civil law partnership or of the board of a stock corporation have signed or, if only one or several have signed, that they have signed also on behalf of the others. As tenants seeking to exit a lease prior to the agreed term often exploit the strict and difficult requirements, it is necessary to check carefully all tenancy agreements for compliance with the statutory form requirements in a due diligence procedure prior to acquisition of the property.

vi Extraordinary termination right for energy efficiency modernisations

A new law came into force in spring 2013 granting tenants an extraordinary termination right if modernisations for energy efficiency reasons will result in an increase of the rent payable by the tenant. The law will apply to commercial as well as residential leases. Landlords will, therefore, have to guard against exploitation of this right by tenants seeking to terminate early their long-term lease for other reasons.

VIII OUTLOOK AND CONCLUSIONS

The German real estate market will undoubtedly continue to provide interesting investment opportunities (see Section II, *supra*).

On the legal front, further developments are to be expected in the area of energy efficiency of buildings. The Energy Savings Ordinance 2009 requires the use of energy-saving materials for all new buildings and in the event of a major refurbishment of existing buildings. Owners are required to prepare energy passports for their buildings, which they have to make available to potential purchasers or tenants of the property. On 1 May 2014, the new Energy Savings Ordinance 2014 will come into force, and will provide for stricter standards, particularly for new construction projects. Pursuant to the Renewable Energy Act, renewable energies must constitute part of the energy supply of newly constructed buildings.

Since further legislative activity is to be expected in this area, and energy efficiency has become an important political issue, the real estate market is reacting: real estate owners and tenants such as large corporations wish to occupy green buildings as part of their corporate identity, demonstrating responsibility for the environment. In the absence of a legal definition of a 'green building', certain systems of certification (e.g., BREEAM, LEED and the German DGNB seal) are being used to arrive at a common understanding of the term, and such certificates are becoming increasingly popular. Investors will, therefore, have to look carefully at the energy efficiency rating of a building at the time of acquisition in relation to investments necessary during the holding period and subsequent exit strategies.

With regard to residential leases, new legislation will be enacted shortly to introduce a maximum cap of 10 per cent above the local rent level on the increase of rents in respect of running leases and of newly concluded leases with new tenants in areas with particularly high demand for residential dwellings.

Changes may also be expected on the tax front. A reform of real property tax is planned and this tax may eventually increase (see Section V.iii, *supra*).

Chapter 13

GREECE

Paraskevi A Anargyrou and Stella G Yannika[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

In Greece, property rights on real estate follow the rule of *numerus clausus* and are essentially ownership, servitudes (such as usufruct) and mortgage. They can be of limited duration, either by law or by agreement, and may be subject to terms or conditions.

Ownership, according to the Civil Code, may be acquired in a variety of ways, such as by transfer, by law, by virtue of judgments or by decisions of the public authorities. A distinction is made between original and derivative acquisition of ownership. The main forms of original acquisition are adverse possession (i.e., acquisition based on the possession of a property over a 10-year period, if in good faith, or a 20-year period, if in bad faith, with the intent to own it), and expropriation, in which case the state decides to deprive someone of his or her property for public interest reasons, set against a full and prompt compensation of the owner. Given that ownership is explicitly protected by Article 17 of the Constitution, this strict restriction is absolutely necessary to safeguard effective protection of private property. On the other hand, the most frequent method of derivative acquisition of ownership is transfer upon agreement. To this effect, the law requires an agreement between the parties, which must bear the notarial form, and its registration with the competent land registry or cadastre. Other cases of transfer of property include acquisition by virtue of succession, by donation and by means of exchange.

Contrary to other systems mainly found in eastern Europe, in Greece, ownership over the land is fully recognised and, generally, there is a rule that any immoveable property attached to the land is vested in the owner of that land. A distinction is made,

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however, as follows: horizontal property is a form of divided ownership in buildings, which applies when there is separate ownership applying to separate parts of the building (e.g., floor or apartment). Horizontal ownership goes together with joint ownership (per thousand rate) on the common areas of the building (e.g., the plot). Vertical property refers to separate ownership on separate buildings that are constructed on a single plot. Combined horizontal–vertical property is when each of the buildings constructed on a plot is divided horizontally in floors or apartments.

Ownership is not always full; it can also be limited, in which case it is called bare ownership. This happens in the case of usufruct – one of the most common servitudes – which gives the usufructuary the limited duration right to enjoy the property as if he or she were the owner, as well as to protect this right by all means.

The provisions of Articles 18–26 of Law No. 3986/2011 have introduced the institution of *superficies*, the constitution of a property right – only in public land – which grants to natural persons or legal entities the right to construct or acquire a building in public land and to exercise in this building the rights provided by their property right. This right is applicable for a specific period (i.e., from five years up to 99 years), it is transferable during a lifetime or as a result of death, and upon its expiry, the building will belong to the owner of the land. The agreed price is payable either as a one-off contribution, or by partial instalments or as rent during the entire period of the property right. The right of *superficies* is taxed like the usufruct.

Mortgage is a real right established on another's real property to secure an obligation by means of preferential satisfaction of the creditor. Again, for the creation of a mortgage, the law requires a legal title granting a mortgage (agreement under notarial form or court decision) and registration with the competent land registry or cadastre. The creditor's ranking is determined by the rule of *prior tempore potior iure*.

ii System of registration

Transfer of ownership and certain other real estate transactions (specified in Article 1192 of the Civil Code) must be registered with the public authorities; this is a prerequisite for the proper acquisition of the respective right. There are two different registration systems in Greece: the land registry system and the cadastral system. The main difference is that the first system follows the owner, while the second system follows the property. Therefore, the second system is preferable, in the sense that it facilitates due diligence of a property and offers increased legal certainty. Currently, both systems operate in parallel, as not all areas of Greece have a fully operational cadastral system yet. The intention, however, is to abolish gradually the land registry system.

iii Choice of law

From the perspective of international private law, real estate property rights are governed by the *lex rei sitae* (Article 27 of the Civil Code). As such, in the case of real estate located in Greece, these relations are governed by the applicable Greek law. The same rule applies, according to Article 12 of the Civil Code, to the required form of contracts having *in rem* effect (i.e., those that create, convey, modify or reduce property rights).

II OVERVIEW OF REAL ESTATE ACTIVITY

2011 was characterised by the substantial deepening of the financial crisis in Greece, and the economic depression worsened still further during 2012 and 2013. The general feeling is one of uncertainty, and there is clearly still pessimism as to how the Greek economy will manage to cope with all its structural problems.

In this sense, the surrounding unstable financial environment has also heavily affected real estate activity in Greece (in both the commercial and residential segments), which is characterised by excessive offer, low demand and a substantial stock of properties for sale. Weak demand reflects pessimism regarding the prospects of the Greek economy, and is being exacerbated by the bureaucracy prevailing in the Greek real estate market, real estate transaction costs and the complex regulatory framework. In 2013, the decline in residential prices continued at a faster pace than in the previous years of the crisis, bringing the cumulative decline to 29.4 per cent for the country as a whole.

This pessimism has not only frozen construction and development, but has also discouraged real estate investors, who appear much more cautious. It is worth mentioning that the National Bank of Greece, after organising the formation and operation of its real estate investment fund (PANGAIA REIC) during the past few years, has suspended its listing on the Athens Stock Exchange. Furthermore, the Hellenic Organisation of Telecommunications has decided to close down its subsidiary vehicle for real estate investments.

It should be mentioned, however, that during the past year two foreign investment companies, Fairfax Financial Holdings Limited and Invel Real Estate, have acquired significant stakes in the two leading Greek real estate investment companies, Eurobank Properties SA and National Pangaea REIC, respectively.

At the same time, the recent progress of the government's privatisation scheme for the utilisation of state-owned land and properties, as well as its further implementation, are expected to provide impetus to the recovery of the real estate market. The Hellenic Republic Asset Development Fund, which is in charge of running and executing all the intended privatisation projects, has launched three main projects in the real estate sector:

- *a* Land development: this involves the utilisation of more than 70,000 public-sector properties that are currently managed or owned by public real estate companies (e.g., KED, ETA) and the various ministries. Development strategies will be designed for single assets or portfolios of assets, as the case might be.
- *b* The former Hellinikon airport area: this is a massive project encompassing the design and implementation of the site development process for what is said to be 'one of the largest urban regeneration programmes worldwide'.
- *c* Real estate: sale and leaseback of a portfolio of 39 properties currently occupied by the Hellenic Republic Asset Development Fund.

During 2013, the Hellenic Republic Asset Development Fund announced the successful conclusion of three bidding processes: the first regards the development of the Kassiopi area on the island of Corfu, the second the development of Xenia Skiathos and the third the development of the real estate in Paliouri area of Chalkidiki. Progress has also been made with regard to the sale and leaseback of 28 buildings occupied by the Hellenic Republic Asset Development Fund: NBG Pangaea REIC and Eurobank Properties

REIC were declared as the successful bidders of the relevant tender process, as well as with regard the acquisition of a majority participation in the share capital of Astir Palace Vouliagmeni SA.

Needless to say, periods of crisis are periods of opportunity. The current crisis will function to a great extent as a corrective measure to the past 'evils' of the Greek economy. Measures and changes that appeared inconceivable in the past, due to their political cost, will become inevitable. The structural inefficiencies of the Greek economy, even if not entirely cured, will hopefully improve; real estate serves as an example illustrating this. As prices fall, investments that currently seem uneconomical will probably appear attractive. Possibly the reason that real estate investment companies are not continuing their investment programmes is not the lack of financing but the expectation of further drastic falls in the price of real estate. The same may apply to other acquisitions, which will become cheaper and should bring new drive and vigour to the economy.

III FOREIGN INVESTMENT

i Fast track

As mentioned previously, the business environment in Greece is, unfortunately, characterised by bureaucracy, administrative procedures and actual disincentives for foreign investors. Despite several efforts to the contrary and the recent implementation (under Law No. 3894/2010) of a fast-track procedure to attract strategic investments through the Invest in Greece Agency (a public entity), the crisis has caused further deterioration, and foreign investment has been discouraged even further by the unpredictable future of the Greek economy. Of course, opportunities are always there, and foreign players are closely monitoring the Greek market, trying to identify targets of interest.

ii Investment incentives

Investment incentives in Greece, constituting a form of state aid, fall within the framework of EU regional policy. To this effect, Greek territory is divided into investment zones with differentiated incentives per region.

A recent investment law[2] that came into force in the first quarter of 2011 replaced Law No. 3299/2004, although this still remains the only applicable law for those investment plans that were approved by virtue of this Law's provisions. Eligible investments include buildings, but acquisition of land is excluded. The eligible activities qualifying for aid and relating to real estate are mainly in the tourism sector (hotels, campsites, spas and winter tourism centres).

Investment incentives are not exclusively addressed to foreign investors, but their use is mentioned as an interesting tool to part-finance eligible projects.

2 Law No. 3908/2011.

iii Controlled areas

There are some controlled areas in Greece that lie close to the borders both to the north and to the east. Special legislation[3] applies in the case of transfer either of real property or of the shares of the company that is the owner of property in such controlled areas. The rationale is that a prior approval by a committee, including the participation of the Ministry of Defence, is required in cases of transfers to a third-country (non-EU Member State) legal entity or individual. In the event of violation of this obligation, the transaction is null and void. Until very recently, the same restriction also applied if the acquirer was a Greek or EU entity, but the property was ultimately owned by a third-country legal entity or individual. The latter indirect check of actual control of the acquirer has now changed.[4] Under the new provision, there is no restriction on transfers to entities having their registered head office within the EU (regardless of who their shareholders are). A recent circular from the Ministry of Defence clarifies the new regime to this effect.

iv Residence permits

Third-country citizens (i.e., non-EU citizens) who buy a property in Greece the value of which exceeds €250,000, and their family members, may obtain residence permits, according to Law No. 3386/2005, as amended by Law No. 4146/2013.

IV STRUCTURING THE INVESTMENT

In line with international standards, an important element when structuring a real estate investment is whether it will take the form of stock purchase or asset purchase. In the first case, this refers to the purchase of a whole entity. In the case of real estate, this normally refers to a special purpose vehicle (SPV), the only basic asset of which is the property to be transferred. In most cases, real estate investments through transfer of an SPV are preferred because of the decreased transfer tax due in such a case, in comparison with the applicable property transfer tax.

In the case of an asset deal, the normal procedure to acquire a property is roughly the following:

a Legal due diligence of the property. This includes inquiry in the land registry or cadastre to verify ownership title and any related disputes or encumbrances. The audit must go back at least 20 years (see Section I.i, *supra*, regarding adverse possession).

b Technical due diligence of the property. This is not always necessary, but in most cases it is strongly advisable to hire an engineer to ensure compliance with any construction restrictions, etc. In any case, the service of an engineer might be considered necessary, as Law No. 4014/2011 requires the issuance by an engineer of an energy efficiency certificate and a certificate regarding the property's

3 Law No. 1892/90, as amended.

4 Article 114 of Law No. 3978/2011.

compliance with the building permits, which both need to be attached to the notarial act.[5]

c Transfer tax return and payment (see also Section V.iii, *infra*).

d Notarial act for transfer of the property.

e Registration of the notarial act with the competent land registry or cadastre.

The involvement of a real estate agent is, of course, only optional. Should someone select to hire one, agency fees should also be considered, which of course is an issue of agreement between the client and the agent, but is usually around 2 per cent of the agreed price.

Another structure that often applies in Greece is *antiparochi* (close to a construction contract), which has been popular in recent decades, especially among the owners of plots with old houses. The context here is that the owner undertakes to transfer to the contractor a co-ownership percentage on the land, as well as part of the separate horizontal properties to be constructed. The contractor, in return, undertakes to construct the building, at no cost to the landowner.

Another significant tool is available to local and international real estate investors in the Greek market: a real estate investment company (REIC) is a particular type of special purpose company, aiming to invest in real estate and governed by special law.[6] A REIC must have a minimum share capital of about €30 million, and needs prior approval by the Hellenic Capital Market Commission. Within a year of its establishment, its shares must be listed on the Stock Exchange. Such companies must invest their funds mainly in real estate (at least 80 per cent), and thus have a wide portfolio of properties so that the risk for the investors is dispersed. The rationale for Greek REICs is the same as that found internationally: they collect money from investors who want a stake in a high-profile real estate portfolio, and to receive a sufficient dividend therefrom. The company invests this money to buy commercial buildings (shops, offices, warehouses, etc.), which are leased on attractive terms. Under the current framework, at least, it is in the very nature of Greek REICs that they must bear no other risk (e.g., regarding construction), and this is the reason why REICs are not a suitable tool for development. So far, there are only a few REICs in the Greek market, and they were initially formed as subsidiaries of banking institutions (for these new developments, see Section II, *supra*). There has been an effort to improve the legal framework of REICs to make them more attractive, and a new law, Law No. 4141/2013, aimed at expanding the scope of REICs' activities and the range of investment options, seems to provide additional incentives that are expected to boost REIC activity and attract new investments.

5 Article 23, Section 4 of Law No. 4014/2011, as amended by Article 49 of Law No. 4030/2011.

6 Law No. 2778/99, as amended.

V REAL ESTATE OWNERSHIP

i Planning

Planning is a very important factor for the realisation of investments in Greece. Recently, there have been important legislative changes dealing with major planning issues in an effort to facilitate investment in Greece. Generally, land uses in Greece are classified according to their general urban plan purpose as pure residence; general residence; urban and local centres; low or medium-disturbance industries or crafts and industrial parks; high-disturbance industries or crafts; wholesale facilities; tourism and recreation; open space free and urban green areas; and common use facilities.[7] Land uses are further specified according to their special urban plan purpose according to the content of each land use category.

For areas beyond the boundaries of settlements (cities or towns) there is a general rule setting building coefficients (known as the 4 stremma rule) that allows buildings to be built on a plot with a minimum area of 4,000 square metres. In many cases, special rules create deviations from or restrictions on the 4 stremma rule, such as in the case of zones of residential control or other regulations that are imposed in an attempt to control unregulated building activities. For example, many of the Cyclades islands have such rules.

In addition to the city planning restrictions, one should also carefully consider certain restrictions that apply to forest areas, archaeological sites, coasts and beaches. There are several provisions thereof, which need to be carefully assessed.

ii Environment

Environment is explicitly protected by the Constitution (Article 24); therefore, the state has an obligation to take special measures to ensure sustainable development. For all people or entities that cause pollution or environmental degradation in general (which includes environmental damage according to Presidential Decree No. 148/2009), there may be sanctions: administrative, with fines ranging between €500 and €2 million, according to the seriousness, frequency and type of violation);[8] and criminal, with sentences ranging from three months to two years in prison, which may increase up to 10 years in cases of serious injury or human death.[9] EU Directive 2008/99/EC regarding the protection of the environment through criminal law provisions is expected to be harmonised into Greek law shortly. The above is applicable notwithstanding any civil law claims for damages.

In addition, in accordance with Laws No. 3661/2008, 3851/2010 and 3889/2010, from 2011, the issuance of energy performance certificates for buildings, which are used for residences (permanent or holiday), offices, commercial purposes, etc., has become mandatory under certain conditions.

7 Articles 230–240 of the Code of Basic Planning Laws.

8 Article 21 of Law No. 4014/2011.

9 Article 28 of Law No. 1650/1986.

iii Tax

Transfer of property

Since 1 January 2006, value added tax at a rate of 23 per cent has been imposed on buildings for which the building permit has been issued after that date, as long as it is the first sale of newly built buildings by a constructor or a professional in this activity. In the remaining cases, a transfer tax is calculated on a progressive scale (i.e., 8 per cent for the first €20,000 of the value of the property and 10 per cent on the excess). Tax is calculated on the value of the contract, which cannot be less than the deemed value of the property as calculated by the tax authorities for tax purposes (this is used as a reference minimum value to reduce tax evasion). This transfer tax is increased by an additional 3 per cent imposed on the tax in favour of the municipalities. Exceptionally, the acquisition of primary residence is under certain circumstances exempt (in full or in part) from transfer tax. Different tax rates apply[10] in cases of succession, donation and parental grant. In these cases, the applicable tax rates vary between 1 per cent and 40 per cent depending on the exact relationship between the parties and the value of the property.

Annual taxes on property

All properties in Greece, belonging to individuals or legal entities on 1 January of each year, are liable for tax of real estate, pursuant to Law No. 3842/2010. In the case of legal entities, there is a flat tax of 0.6 per cent on the value of the real estate property in Greece, which is reduced to 0.1 per cent for the buildings used by the company, but not less than €1 per square metre of the building. In the case of individuals, tax is calculated on the total value of the property that exceeds €200,000, and ranges from 0.2 per cent up to 2 per cent.

Another special levy (introduced by Law No. 2130/1993) is imposed annually in favour of the municipalities and is calculated as 0.25 per cent up to 0.35 per cent of the value of the property.

A special annual tax is imposed at a rate of 15 per cent on the value of the real estate of companies established in non-cooperative states that own the freehold or usufruct of real estate located in Greece, unless the ultimate owner (individual) is disclosed. Certain exceptions from the above tax are provided.

Real estate duty

A special real estate duty was recently imposed on real property with an electricity supply on the basis of the square meterage of the built surface of the building, its age and the price of the city zone. The duty is collected by the public electricity company, DEH, or alternative suppliers of electricity, through utility bills.

iv Finance and security

The consideration for the purchase of real property is often financed through long-term bank loans. In the case of stock deals, bank financing could also take the form of covering

10 Article 29 of Law No. 2969/2001.

a common bond loan issued by the SPV that owns the property. Bond loans in Greece have favourable treatment and fewer expenses, and therefore are preferred by investors.

In either case, a preliminary mortgage is normally granted as security in favour of the bank. This form of security is very close to a mortgage, the difference being that it is only granted by the court (in a one-day procedure), it is conditional and it must be promptly switched into a mortgage. Additional securities in favour of the bank could be third-party guarantee, or assignment of lease and insurance contracts.

Another way of financing real estate investment is financial leasing. This provides the significant advantage of economically acquiring the direct use of real estate without any need for direct disbursement of funds. Title of ownership over the leased property is normally agreed to be transferred to the lessee upon expiration of the agreement. There is a special law in Greece governing financial leasing of real estate or machinery[11] – equipment intended to be used for commercial or professional activity – which provides for certain favourable treatment (tax exemptions, etc.). Such transactions can also take the form of sale and leaseback, which is often used in cases of commercial buildings and is another tool to achieve long-term financing. Although much more popular a few years ago, financial leasing, following the general trend of bank financing, has also decreased under the current climate in the Greek market, because evaluations of buildings have fallen drastically and the banks are reluctant to inject money.

VI LEASES OF BUSINESS PREMISES

There is a minimum 12-year duration set by law regarding commercial leases in Greece (Presidential Decree No. 34/1995) to secure stability for the professional activity of the lessee. Although the parties are free to agree a longer duration, a shorter contractual term is not allowed to be agreed in the initial lease. This can lawfully be put into effect only if there is a separate, later agreement, the exact date of which is duly certified (by a public authority, etc.).

The commercial lease agreement does not need to have a particular form other than being a private agreement. Notary form and registration with the land registry is only required, according to the Civil Code, in the case of residential leases with a duration longer than nine years, if the lessee wants to be protected against a new owner (should the lessor transfer the property during the lease term). Such protection in commercial leases applies in any case without further formalities.

As for the amount of the rent, the parties are free to decide and mutually agree on this; however, an issue could be raised if the agreed rent is wholly inconsistent with the applicable market rate and contrary to good faith. Indeed, in the current market situation in Greece, it is very common for lessees to pursue a reduction of rent due to the financial crisis and the radical change in the market conditions. If not mutually agreed with the lessor, the case is brought before a court, and the tendency of the court under the present circumstances is usually in favour of the lessee.

11 Law No. 1665/86, as amended.

For the eviction of a lessee who refuses to pay the rent, a court order is required following a petition of the lessor. This procedure is fairly fast compared with ordinary lawsuits, which apply to other cases of lease disputes (e.g., bad use of leased property), but which, under the current *modus operandi* of the Greek courts, will probably take a couple of years to obtain a final decision to enforce.

Stamp duty at a rate of 3.6 per cent is payable on the annual rental income for commercial leases, while there is no stamp duty in the case of residential leases.

VII DEVELOPMENTS IN PRACTICE

A widespread phenomenon in the Greek real estate market is that most buildings are constructed in excess of the limitations set by law. For example, if there is a plot with an area of 200 square metres and a 0.5 building coefficient, then the building permit cannot provide for a building larger than 100 square metres; however, in many cases the actual area of the building is still more than that. It can also happen that buildings are constructed with no permit at all. In view of this reality, the Greek parliament has recently voted for two amnesty laws, covering cases of such violations:

a Law No. 3843/2010 provides that owners of buildings with a permit issued until 2 July 2009 may pay a fine and, under certain conditions, be granted immunity for 40 years, in the case of secondary-use spaces that have been turned into primary-use spaces.

b Law No. 4014/2011 provides that owners of buildings completed by 28 July 2011 may pay a fine and, under certain conditions, be granted immunity for 30 years, in the case of buildings in excess of the permit or without a permit at all.

VIII OUTLOOK AND CONCLUSIONS

It seems as though Greece is going through its deepest crisis in recent years, and it is only logical that this situation should cause a further reversal in the market. It is certain that the recession will continue throughout 2013 and 2014 in Greece, which will in turn continue to have effects on real estate activity.

The market will be looking closely at the measures to be taken by the Greek government, which must start to improve the structural problems of the economy (i.e., measures to increase competitiveness and recreate an optimistic and attractive business climate). Investors are expected to follow a cautious and conservative path; however, this should not necessarily prevent them from considering and assessing potential opportunities for real estate activity.

Chapter 14

HUNGARY

Péter Berethalmi and Kata Molnár[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

The general legal framework governing the types of real estate ownership is set out in the Act on Arable Land, the Act on Real Estate Registration and the Civil Code of Hungary. From 1 May 2014, the Act on Arable Land shall cease to exist, and the rules on arable land will be regulated by the Act on Trade of Agricultural and Forestry Lands. According to the rules, Hungarian private individuals and legal entities may acquire the ownership of real estate freely; however, a few restrictions and prohibitions exist.

Acquisition of ownership of non-arable land generates restrictions on non-resident legal entities and private individuals because in this case an authorisation is required. The rules for authorisation of EU nationals, and legal persons and entities without legal personality established in any Member State, are different from those for non-EU residents (see Section V, *infra*). For an investor, a more likely solution may be to set up a business or establish a branch office in Hungary, or to join a Hungarian business as a member or acquire participation (shares) therein.

The regulations on acquisition of ownership of arable land also differ depending on the acquirer. Hungarian private individuals may only acquire arable land up to a limit of 300 hectares in terms of size, or 6,000 gold crowns in terms of quality rating.[2] Hungarian legal entities and organisations that are not legal entities may not acquire ownership rights of arable land; however, the state of Hungary, local governments and public foundations are exempted from this prohibition. The acquisition is also disallowed in the case of

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2 The gold crown system was introduced in Hungary in the second half of the 19th century and is still used to express the value of agricultural land.

non-resident legal entities and private individuals; if, however, an EU national wishing to settle in Hungary to engage independently in agricultural production has been residing legitimately in Hungary for at least three consecutive years and pursuing agricultural activities, the provisions pertaining to resident private individuals apply.

From 1 May 2014, the new Act on Trade of Agricultural and Forestry Lands will regulate land acquisition. According to the new Act, Hungarian private individuals and EU nationals that are not agriculturalists[3] may only acquire land up to a limit of 1 hectare in terms of size. An agriculturalist may acquire land up to a limit of 300 hectares in terms of size, but acquisition of land is disallowed to non-resident private individuals, states other than the Hungarian state and legal entities. However churches, mortgage loan companies and local governments may acquire ownership of land.

There is a further prohibition that real estate owned exclusively by the state or real estate prescribed by law are not subject to trade; hence, the alienation of such real estate will be deemed as null and void.

ii System of registration

Any private individual or legal person contemplating acquiring real estate in Hungary should have an understanding of the system of land registration. The land registry is a large official database that records the most important data and information for all Hungarian real property, along with any relevant rights and facts of significance for legal purposes.

Land registry records are deemed authentic proof of registered rights such as ownership rights, usufruct, right of use, mortgage, right of execution and also the facts relating to the property. The registered rights and recorded facts – for the benefit of a *bona fide* acquirer – are considered true until proved otherwise. For the purposes of land registration, a person acquiring a right in real property by payment of a consideration and trusting the land registration will be deemed a *bona fide* party.

The registration system helps to guarantee the safety of real estate transactions, because any alteration, such as registration, modification and cancellation of certain data and information, must be registered in the real estate register, and this activity falls under the jurisdiction of the Land Title Office.

The land registry has a significant role in relation to any real estate transfer, as the change of owners must also be registered upon the transfer of ownership (beyond the contract for transfer or other legal titles). In this case, the ownership right is created upon being recorded in the real estate register. Hence, if the purchaser fails to register the change of owners, the acquisition will be effective only between the purchaser and the seller, but will be ineffective against third parties. Furthermore, it is possible that a person

3 Agriculturalist refers to a Hungarian private individual or EU national registered in Hungary who has an agricultural or forestry qualification or, lacking this, who pursues independently an agricultural or forestry activity in Hungary for at least three years under his or her own name and risk, or who is a member in an agricultural production organisation registered in Hungary in which it has 25 per cent ownership.

may acquire title outside the scope of land registry, but may not enforce it against *bona fide* third parties that rely on the land registry.

In addition, the register, and thus all relevant information about Hungarian real estate, is open to everyone, including foreign investors. The Land Registration Office issues land certificates regarding real property in Hungary and these can be obtained and reviewed without restriction by any person; however, the documents on which the registration is based can be reviewed only with the approval of the interested parties.

iii Choice of law

With regard to the transfer of Hungarian real properties, it is important to clarify which law is applicable. Generally, in the case of ownership and other property law, the law of the jurisdiction in which the asset is located is the governing law. Hence, as far as Hungarian real property is concerned, Hungarian law applies. Generally, the parties are not entitled to choose law different from that which is applicable at the location of the asset. There are, however, a few exceptions; in matters other than ownership and property law, the applicable law depends on the actual legal matter at hand.

II OVERVIEW OF REAL ESTATE ACTIVITY

In 2013, the market continued to be affected by the global recession, since it had not really started up again. The most noticeable features of the market included stagnation, low prices, unexploited properties, difficulties with financing, and a lack of demand and new developments. In 2013, the number of real estate investments continued to diminish; investments in Hungary in 2013 amounted to only €100 million, which is the same level as that in 2000. This shows the definite effects of the recession: prior to 2008, this figure was over €1,000 million. Apart from the recession, a lack of centrally located prime real estate and lack of correspondence between demand and supply may be contributory factors to the decision by foreign investors not to commit to the Hungarian market.

Generally, investors look for top-quality buildings that conform to the current trends. In the case of offices, the most important requirements are generally a good location, a high standard of architecture, design and innovation, and environmentally friendly technologies. In the retail market, certain trends may be significant in relation to commercial properties: a promising concept is the development of multifunctional or themed shopping centres, designed to be indispensable locations in people's lives, including their social lives. The increase in the size of these centres and their use of green or park areas has also helped to create an environment for market success.

III FOREIGN INVESTMENT

The Hungarian rules afford foreign investors complete protection and safety in relation to their investments. Non-resident private individuals and legal persons may also regularly pursue business activities in Hungary. Foreign nationals may establish business associations without restriction, and there are also several tax incentives, such as corporate tax allowances (if the value of the investment is above a certain amount) and, in the case of real estate investment trusts (REITs), the lack of corporate tax liability.

Foreign nationals may generally invest under the same conditions and enjoy the same protection as Hungarian investors; there are, however, a few restrictions (see Section I, *supra*) on the acquisition of ownership of real estate located in Hungary.

In general, aside from the prohibition on the acquisition of arable land, there are no direct restrictions on foreign investment; however, non-resident private individuals and legal entities may acquire title of ownership to real estate only with authorisation from the competent administrative authority. EU nationals, legal persons and entities without legal personality established in any EU Member State may acquire title of ownership to real estate not qualified as arable land under the same conditions applicable to resident persons.

IV STRUCTURING THE INVESTMENT

In terms of real estate investment structuring, foreign investors have several options. They may choose direct investment, and within this, the direct purchase of a Hungarian real property. As mentioned previously, Hungarian law provides that investment by foreign nationals enjoys full protection and security, and generally there are no restrictions on foreign investment. A non-resident individual or legal entity may invest in Hungary directly, without establishing a business association, branch office or a commercial representation, but authorisation from the competent administrative authority is required in the case of real estate investment (especially the acquisition of Hungarian real estate).

It is possible, nonetheless, for investors to establish or buy project companies and also to acquire participations therein. These special purpose companies are established for a definite construction purpose, such as the completion of a new project or a new building. In contrast with direct investment, the owner of the completed project is the project company itself. The main business structures for project companies are limited liability companies and private limited companies. These are the most common business vehicles in Hungary, because they can be established quickly and have the further advantage of limited liability, which means that (with the exceptions set out in the Companies Act) members will not be liable for the liabilities of the company. Another advantage is the absence of restrictions, or special taxes in respect of foreign investment, on the ownership of a project company; however, investors have recently shown a preference for direct investment, to avoid the liabilities of the project companies issued in the past.

Foreign business entities may also establish branch offices and commercial representations. A branch office is an organisational unit of a foreign company, without legal personality, vested with financial autonomy and registered as an independent form of company in the Hungarian company registration records. Foreign companies are entitled to conduct entrepreneurial activities through a branch office or offices registered in Hungary. A commercial representative office of a foreign company is not involved in business activities in its own name, but is also registered as an independent business entity in the Hungarian register of companies. In addition, it engages – in its own name and on behalf of the foreign parent company – in the mediation, preparation and conclusion of contracts, provision of information to clients and partners, and other client-related service activities.

Tax rules are applicable to all of the above-mentioned entities. Companies that pursue business activities for profit in Hungary must pay corporate tax. Taxpayers are subject to corporate tax liability on their income pursuant to the provisions of the Act on Corporate Tax. The tax liability of a resident taxpayer commences on the date when the memorandum of association is drawn up, signed and certified in due legal form. As regards a branch office, the tax liability of a non-resident enterprise commences on the day this branch is entered in the register of companies and terminates on the day it is removed.

A further option, one that offers tax advantages to foreign investors, is the foundation of a REIT, in the form of a public limited company (see Section VII, *infra*). While REITs currently enjoy exemption from corporate tax liability in Hungary, the mandatory 10 billion forint start-up capital does present an obstacle to the investor, and limited liability companies and companies limited by shares are more likely to be set up than REITs.

V REAL ESTATE OWNERSHIP

i Planning

Hungarian law provides obligatory rules and regulations regarding the establishment and development of any real properties. According to the Act on the Formation and Protection of the Built Environment, the rules of construction works and activities are regulated at both national and local level. Relevant national regulations regarding planning must be created by the state, and any type of construction work, such as building, expansion or a change of function, must be carried out in accordance with the national rules. Beyond this, local rules specific to the location of the real property also need to be fulfilled. All local requirements, rights and obligations are laid down in the local building code adopted by the local government.

A change in the function of an existing structure will only be allowed if it makes proper use of the area and is consistent with public policy. In addition, construction works may only be carried out, in general, upon conclusion of any relevant proceedings with the building authorities, such as those regarding building permits, demolition permits, occupancy permits or continuation permits.

ii Environment

Along with the above-mentioned general requirements, construction works must also be carried out in accordance with environmental obligations. Depending on the location of a structure, *inter alia*, special requirements regarding environmental protection and conservation of nature areas must be followed. As a general rule, the entity making use of the location is also liable for any harm caused or any imminent threat posed to the environment, and must contribute to any costs of prevention and remediation. Liability for environmental damage may fall jointly and severally upon the party registered as the owner or possessor (user) of the property; this party may be exempted from joint and several liability if it is able to identify the actual user of the real property and to provide proof beyond any reasonable doubt that liability lies solely with the actual user.

In the event of failure to comply with the requirements, the environmental authority may limit, prohibit or suspend the activity causing harm to the environment, or a fine must be paid.

iii Tax

In Hungary, the purchaser must pay a duty on the transfer of real property to the tax authority. In a case of onerous transfer, the general rate of duty for the acquisition of real property is 4 per cent of the market value of each property acquired up to 1 billion forints, plus 2 per cent of the portion of the market value above 1 billion forints (not exceeding 200 million forints per property). The duty on transfer is due upon the conclusion of the sale and purchase agreement, before the transfer of the real property is completed and registered in the land registry.

On the acquisition of shares in a company with holdings in real estate properties located in Hungary, the beneficiary must pay duty if such holdings reach or exceed 75 per cent of the company's total capital (see Section VII, *infra*).

When the purchase of real property by foreign nationals involves authorisation, 50,000 forints must be paid for each property as a duty to obtain the necessary permit. Real estate-related proceedings such as those before the land registry or the building authority also generate duty.

iv Finance and security

The most common form of security granted over a real estate is a mortgage. In the event of a mortgage, the charged property remains in the possession of the obligor, who is entitled to use and utilise it. Real estate may be charged as security only in the form of a mortgage. A mortgage will only be considered valid if contracted in writing and recorded in the land registry. In practice, besides mortgages, a right of purchase (option) may also be a form of security. The owner of real estate may grant, by means of a unilateral statement, an option to another party entitling that party to buy the real estate. This option can be stipulated for a maximum of five years, and any option stipulated for an indefinite period automatically expires after six months. According to the new Civil Code, effective from March 2014, the above time limitation shall cease to exist, and the option can be stipulated for an indefinite period of time and does not expire after six months. Agreements on options to purchase must be concluded in writing, with the object and the purchase price specifically indicated.

VI LEASES OF BUSINESS PREMISES

The Flat Lease Act provides obligatory provisions for the lease of flats and commercial premises.

The Act regulates the occupational lease of premises (office rental) that qualify as non-residential premises. The conclusion of the office rental agreement must be made in writing between the lessor and the lessee. An agreement in breach of these conditions shall be deemed null and void. Both the lessor and the lessee may be foreign private individuals, legal entities or other organisations that are not legal entities, without restriction.

The main obligations of the lessee are the proper use of the premises in accordance with the contract, and the payment of the office rent. The amount of rent will be determined in the contract by the parties, and there is no specific obligatory provision in relation to this. The lessor may inspect the lessee's proper use, and is entitled to claim for compensation if the lessee does not fulfil its obligations and causes any damage in the premises. In addition, if the lessee fails to pay the office rent according to the contract, the lessor may seize the assets of the lessee located in the premises up to the amount of the unpaid office rent. The most typical securities in the case of rent agreements, however, are the bank guarantee and the deposit.

The lease contract may be valid for an indefinite period, for a specified term or for an unspecified term until certain conditions are fulfilled. In the last two cases, the agreement is terminated upon the expiry of the agreement term or upon the occurrence of the conditions defined in the agreement. Lease agreements concluded for an indefinite period can be terminated by a party vacating the lease. Furthermore, the parties may always terminate the contract by mutual agreement. Typically, contracts are agreed for a five-year period and, after renegotiations, are subsequently extended.

In the Hungarian office lease market in 2013, stagnation continued in the cases of occupational premises, business premises and offices. A few new developments were completed in 2013 in the field of office premises (e.g., the completion of Bosch Center and the VáciGreens office park (see Section VIII, *infra*)). In east Hungary, occupation of offices diminished; however, occupation of offices increased in west Hungary. The property index, which summarises investor expectations, descended three points in the case of Budapest. In general, the market continues to stagnate.

Demand and the occupational rate also remained diminished in the case of industrial premises. The only new development in this area in 2013 was the completion of the Budapest Airport Business Park, which offers a further 10,800 square metre area of industrial premises for lessees and investors.

Despite optimistic expectations for 2013, a lot of premises remain unoccupied, the number of vacant properties has not reduced and rents are is still at a low level in the cases of offices and apartments.

In 2014, rents will probably increase, the number of empty, unexploited premises should decrease and, of course, more developments are to be expected. The first build-to-suit developments were completed at the end of 2011, and it is anticipated that we will see more of these in the future, as they are well suited both to current trends and to demand.

VII DEVELOPMENTS IN PRACTICE

The last three years have seen several new developments in real estate law and practice in Hungary that may have implications for foreign investment.

i Duty and tax changes

Changes in duty on the transfer of real property, effective from 1 January 2013, may have an effect on investment in Hungary. The rules have changed regarding duty on the transfer of apartments. Until 2012, in a case of onerous transfer, the rate of duty for apartment purchases was 2 per cent of the market value up to 4 million forints and 4 per cent of the part above this threshold. From January 2013, the rate of duty for the acquisition of any apartment is 4 per cent of the market value of each apartment. This means that, for an apartment valued at up to 4 million forints, the buyer shall pay an extra 80 thousand forints upon acquisition. The duty on the transfer of apartments is, therefore, less favourable than it was in 2012; however, this does not amount to a significant increase in the buyer's obligations, and it is unlikely that this amendment will have a negative impact on investment.

ii Real estate investment trusts

The Act on Real Estate Investment Trusts, effective since 27 July 2011, is another recent development. This type of corporate entity is well known in many other European countries, but new to the Hungarian market. According to the Act, every REIT will be set up in the form of a public limited company with start-up capital of at least 10 billion forints, and will pursue defined activities in either Hungary or other countries. These activities are the purchase of real estate, the lease and operation of real estate, property management and real estate investment management. The state tax authority registers those public limited companies that function as REITs, and also may police the fulfilment of conditions laid down in the Act. These entities receive preferential tax and duty treatment. Basically, companies that pursue economic activities for profit on a regular basis and other similar gainful activities (business operations) must pay corporate tax. The Act notwithstanding, every company qualified as a REIT is exempt from corporate tax and local business tax: only the owners of the REIT must pay tax according to the profit and dividend. The main purpose of the REIT Act was to promote the activity of companies that invest in commercial premises and real estate with financial assets collected from small and other investors, and therefore encourage development in real estate. Despite the advantageous tax and duty situation, to date there is no company registered in Hungary as a REIT, and this may well remain the situation for the foreseeable future. The stagnant market produced by the recession and lack of capital affords little prospect of such a company being set up.

iii The Plaza Stop Decree

Another new measure, the Plaza Stop Decree, effective from 1 January 2012,[4] declares a general moratorium on building commercial units exceeding an area of 300 square metres, unless permitted by the committee established by the Minister for Rural Development. While this three-year moratorium on commercial developments does affect hypermarkets in particular, the development of major shopping centres has already seen a slowdown as a consequence of a saturated market and decreasing personal consumption. The reasoning

4 Part of the amendment of the Act on the Formation and Protection of the Built Environment.

behind the decision to implement this measure was to alter the structure of commerce to give a more important role to domestic enterprises, and to promote and sponsor the retail trade; however, the restraint of commercial developments for three years clearly affects investment possibilities, and may deter serious foreign investors. Some opine that major development companies will stay away from Hungary in future and, in the worst-case scenario, those already present may even withdraw from the country because of the regulation.

The Decree has been in place for a year and primarily affects the development of grocery stores and hypermarkets. Thus far there have only been a few cases in which the committee established by the Minister for Rural Development has permitted the establishment of commercial units exceeding an area of 300 square metres.

VIII OUTLOOK AND CONCLUSIONS

At present, the Hungarian real estate investment market is still stagnating: there is no economic growth, demand is scarce and the banking system's whole engagement in the financing of property projects – in terms of capability, willingness and overall activity – still follows a negative trend. There are no favourably anticipated legislative measures or proposals pending, and the economic situation continues to generate insecurity. The market will probably continue to suffer from the same problems in 2014; however, there were a few new developments and trends in 2013.

There is still interest in commercial property developments. Despite the level of saturation in the Hungarian market, with few remaining areas worthy of being built up, plans for the construction of new shopping centres and sites in both the capital city and the country are under consideration. In 2013, two major developments were completed in this area. The Árkád 2 shopping centre in Budapest was handed over in March 2013, and seems as popular as Árkád itself; 95 per cent of its premises are occupied, which will probably increase to 100 per cent very soon. The other newly completed shopping center in Budapest is the first luxury centre, the 4,000 square metre II Bacio di Stile in the middle of Andrássy Street. However, KÖKI shopping centre, which was handed over in 2011, is now up for sale due to bankruptcy.

Expectations are positive for the apartment market: the rents and prices of apartments in Budapest are still low, which offers a great opportunity to investors. According to the surveys completed in 2013, lots of investors are buying apartments in Budapest due to the low prices and are leasing them. Compared with other European cities, Budapest has the most favourable prices.

In the office lease market, most transactions are renegotiations and contract extensions. Existing contracts notwithstanding, there have been some new deals, but stagnation is also expected in 2014. The one main development in this area in 2013 was the handing over of the A category VáciGreens office park, which has LEED Platinum certification and currently offers 18,000 square metres of office space. The occupational rate of its premises was 93 per cent within a few months of completion, and the park also won the Project of the Year award. In 2014, in the field of offices, demand will probably focus on such developments.

Chapter 15

INDONESIA

Eddy Marek Leks[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

Under Indonesia's Basic Agrarian Law, land rights are divided into the following types:

a Right of ownership: this inherited land right is the strongest and fullest right that can be owned by a party. Only an Indonesian citizen, and some legal entities determined by the government, can obtain right of ownership.

b Right to build: the right to build and own buildings over another party's land for a term of up to 30 years, which can be extended for a term of up to 20 years and can be renewed. An Indonesian citizen or Indonesian legal entity can obtain this right. The right to build can be granted over state land, right of management and right of ownership.

c Right to cultivate: the right to cultivate land controlled by the state for farming, fisheries or animal husbandry. The right to cultivate is granted for a term of up to 25 years, or up to 35 years if required by a company, and can be extended for a term of up to 25 years. An Indonesian citizen or Indonesian legal entity can obtain this right.

d Right of use: the right to use and take the fruits of, or simply take the fruits of, land that is directly controlled by the state, or of another party's land. Right of use can be granted for a definite term or indefinitely as long as the land is used for a specific purpose. An Indonesian citizen, a foreign national domiciled in Indonesia, an Indonesian legal entity or a foreign legal entity having its representative office in Indonesia can obtain this right. Right of use is granted for up to 25 years and can be extended for up to 20 years.

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e Right of lease: the right to use another party's land for building purposes by paying the owner a sum of money as rent. An Indonesian citizen, a foreign national domiciled in Indonesia, an Indonesian legal entity or a foreign legal entity having its representative office in Indonesia can obtain this right.

ii System of registration

The purpose of land registration is as follows:

a To provide legal certainty and legal protection to the holder of a land right, right of ownership of condominiums and other rights by facilitating secure and easy identification of the right holder. The right holder will receive a land title certificate.

b To provide access to information to interested parties who require data or to perform a legal action over registered land and condominiums. The registers of land and condominiums are accessible by the general public.

c To provide for the proper administration of land and condominiums, including their transfer, encumbrance and removal.

The state does not guarantee the accuracy of the data in the Indonesian land registration system, and in that respect it is a negative system. However, the system has a positive element: if a land title certificate has been issued properly and registered under the name of an individual or legal entity that obtains the land in good faith and actually controls the land, any party wishing to claim a right over land and claim the use of that land must make an objection in writing to the title certificate holder and the head of the Land Office, or file a claim to the court in relation to the control over the land or issuance of the land title certificate, within five years of the issuance of the title certificate.

iii Choice of law

Transactions of land in Indonesia are governed by Indonesian law. Every transfer of a land right and right of ownership of condominium through sale and purchase, exchange, bequest and other legal action to transfer the right, except for the transfer of the right through auction, can only be registered if it is evidenced with a deed from an authorised land conveyancing officer (PPAT) appointed by the national Land Office. The formation of this deed is witnessed by all parties concerned and at least two qualified witnesses. The form, contents and manner of preparation of the deed are stipulated by law.

II OVERVIEW OF REAL ESTATE ACTIVITY

The real estate market is still growing in Indonesia. Nevertheless, there are some factors that need to be noted by developers. First, the Bank of Indonesia (BI) rate has increased to 7.5 per cent, which impacts the interest rate on home ownership loans. Second, BI has stipulated a progressive loan-to-value ratio for second home ownership loans and limitations on home ownership loans for to-be-built properties. This may reduce the absorption of property units in the market. Further, there will be a presidential and lawmaker election in 2014, and many investors are waiting until after the election to make investment decisions. It is hard to predict whether those factors will hugely disturb the real estate market; nonetheless, they may reduce sales of property units in the market.

Financing is freely available, with many banks and financial institutions offering real estate financing to their customers; they compete in offering fixed and capped interest rates and other features to attract customers to take out loans with them. An important component in the real estate finance market is the availability of the mortgage right, which can be enforced by the banks and financial institutions as security against customer defaults. This mortgage right is stipulated under Law No. 4 of 1996 on Mortgage Right over Land.

Discussions on foreign ownership are ongoing, and the topic is often raised by Real Estate Indonesia, a well-known real estate organisation in Indonesia. It has requested the government to revise the current Agrarian Law or amend Government Regulation No. 40 of 1996 on Right to Cultivate, Right to Build and Right of Use Over Land, to make lenient provision for a foreign national or foreign legal entity to be able to purchase land rights in Indonesia. The revised draft of the Government Regulation has been prepared by the government; however, to date no revised version has been promulgated. The government had promised to issue the revision by the time the FIABCI World Congress 2010 was held in Bali; however, despite continuous requests by private parties in Indonesia for the government to amend the land law, it has not taken any steps on the matter. Essentially, to allow a foreign national or foreign legal entity more freedom to purchase land in Indonesia, the Basic Agrarian Law must be changed; however, the Law is so fundamental in Indonesia that the government will face many obstacles to its revision.

III FOREIGN INVESTMENT

Under the current regulations, a foreign national whose presence is in the national interest can own a house that is built over a right of use over state land, or that is subject to an agreement with the holder of a land right, and own a condominium that is built over a right of use over state land. The law further stipulates that ownership of a house and means to acquire land rights by a foreign national can be realised by the following means:

a construction or purchase of a house over land with a right of use over state land or a right of use over a right of ownership;

b purchase of a condominium that is built over a right of use over state land; and

c construction or purchase of a house over a right of ownership or right of lease by written agreement with the holder of a land right.

To conduct real estate business in Indonesia under the current law, a foreign national or foreign legal entity must establish a limited liability company (PMA). Currently, there is no restriction on a foreign national or foreign legal entity establishing a wholly foreign-owned PMA company in the real estate sector.

Under Indonesian investment law, there are facilities and incentives available to foreign investors, including:

a income tax through a reduction of net income to a certain stage on a certain period;

b import duty relief or exemption on imports of capital goods, machinery or equipment for production processes not yet developed in Indonesia;

c import duty relief or exemption on imports of raw or auxiliary materials for the purpose of production for a certain period and subject to certain conditions;

d exemption or postponement, for a certain period, of value added tax (VAT) on imports of capital goods, machinery or equipment for production processes not yet developed in Indonesia; and

e accelerated depreciation or amortisation and relief on land and building tax for certain business sectors in certain regions, areas or zones.

A new Regulation (BKPM No. 5/2013, promulgated in May 2013 as amended by Regulation No. 12 of 2013) issued by the Indonesia Investment Coordinating Board (the BKPM) sets forth new investment requirements for PMAs. According to the new Regulation, PMAs must have a minimum investment (i.e., capital, loans and retained profits) of 10 billion rupiahs with issued and paid-up capital of at least 2.5 billion rupiahs. While the Regulation does not impose any capital-to-loan ratios, in practice the BKPM has often required that in addition to the 2.5 billion rupiah reserve minimum, the capital reserves be increased in proportion to loan risks. The result of the Regulation is that PMAs with low equity are unable to enter Indonesia. This new Regulation straightens out the capital requirement and also emphasises that a low-equity PMA may no longer enter Indonesia.

The law for limited liability companies has different capital requirements that should also be taken into consideration and complied with. Under this law, companies must have a minimum authorised capital of at least 50 million rupiahs with a minimum 25 per cent as issued and paid-up capital.

The new Regulation also introduces a three-year time frame for completion of projects set out in foreign investors' business plans. Longer timescales may apply for certain specific business sectors. In the event of failure to complete a project within the applicable time frame, the BKPM will grant an audit, following which the licence will either be extended for another single term of three years or revoked.

IV STRUCTURING THE INVESTMENT

The PMA may be structured in several ways; no one set structure suits all. In practice, the PMA company may be structured as a wholly foreign-owned incorporated joint venture company, as an incorporated joint venture company with a local party, or through strategic cooperation between the PMA and an Indonesian legal entity in Indonesia.

i Incorporated wholly foreign-owned PMA

PMAs are subject to Law No. 40 of 2007 on Limited Liability Companies. Under the Law, the company must be established by at least two shareholders. The PMA, therefore, must be established by two foreign shareholders, with at least one nominated and appointed member of the board of directors and one of the board of commissioners.

The distribution of shares in the PMA is determined by the foreign shareholders, but is not important so long as the two foreign shareholders are affiliated or within one group.

The advantages of this type of structure are that the foreign shareholders have full control over the management of the PMA and they will receive 100 per cent of the profits since they fully own the PMA. As the controller, the foreign shareholders may choose and appoint the members of the PMA's board of directors and board of commissioners. Since, however, they fully own the PMA, the foreign shareholders have to bear in full the high risk of starting a real estate investment in Indonesia; foreign shareholders may not be aware of the current laws and regulations in Indonesia, especially those relating to real estate business.

ii Incorporated PMA part-owned by a foreign national or foreign legal entity and partly by a local party

Foreign shareholders may fully own the PMA, but they may choose to invite local partners to be shareholders. Generally, local partners have a minority shareholding, while the foreign shareholders hold the majority shareholding and retain management control.

The advantages of this structure to foreign shareholders are clear: they obtain local expertise on Indonesian real estate, particularly aspects of licensing that are, initially, potentially confusing for foreign shareholders. Most real estate licences are issued by the largely autonomous local government. Although licensing procedures and regulations are determined at national level, they are implemented under local government regulations. Local expertise is, therefore, very important for foreign shareholders: as well as reducing the risk of business failure, the local partner may assist in identifying suitable land for development or may itself own property that it can inject as capital into the newly established PMA. In this way, the PMA may be established with assets ready to be developed. On the other hand, the profits of the PMA must be shared with the local partner.

iii Strategic cooperation between the PMA and a local partner

The other structure used by foreign shareholders is one of strategic cooperation with a local partner already established in the Indonesian real estate market. The foreign shareholders can establish a PMA, fully owned by them, and then enter into a strategic cooperation with the *bona fide* local party. The foreign shareholders obtain local expertise and access to local markets, while the local party may obtain international recognition for its Indonesian real estate brand. This cooperation may result in co-branding of two companies. A strategic cooperation between eligible, *bona fide* parties produces a win-win situation.

V REAL ESTATE OWNERSHIP

i Planning

The applicable regulation is clear that, prior to development or use of land, parties must obtain a spatial utilisation licence. Spatial utilisation licences are given to guarantee that spatial use is in accordance with spatial planning and zoning regulations, and to prevent any negative impact from spatial utilisation and to protect the public interest.

The following different forms of spatial utilisation licence are all issued by local government:

a In-principle licence: a licence issued by the local government allowing, in principle, a certain activity. This type of licence may be in the form of a land utilisation appointment letter.

b Location licence: a licence permitting the applicant to obtain the required space to perform its activities. This licence is required for the performance of relinquishment of a land right. Local regulations may require a location licence to be based on an in-principle licence.

c Land utilisation usage licence: this licence is required to apply for a building construction licence.

d Building construction licence: this licence is required to construct buildings (additional types of licences may be required by local laws).

A location licence may not be required if certain conditions are met under the applicable regulation (e.g., if the required land is not more than 25 hectares for farming business or not more than 10,000 square metres for business other than farming).

ii Environment

The party responsible for the business and its activities is obliged to recover contaminated land from hazardous and toxic material waste (B3). The recovery procedure for contaminated land comprises a contaminated land survey, determining a source location to obtain a contaminated land sample and recovery of the contaminated land.

The stages of the recovery process are as follows:

a mapping of contaminated land;

b isolation of contaminated land;

c display of warning signs;

d sampling of contaminated land;

e lifting and transport of contaminated land;

f recovery of contaminated land;

g monitoring of contaminated land; and

h backfill, then restoration of vegetation.

The land will be passed as clean from B3 contamination after evaluation according to the procedures set out in the regulations. The party responsible for the business and its activities must monitor the contaminated land at least once every six months for one year. The results of this supervision are submitted to the relevant government minister with copies to the governor of the province and the relevant mayor or regent.

iii Tax

The taxes or stamp duty on the acquisition of real estate in Indonesia are as follows:

a land and building acquisition levy of not more than 5 per cent, paid by the purchaser, calculated on the transaction value or taxable object value, whichever is higher;

c income tax at 5 per cent, paid by the seller, calculated on the transaction value or taxable object value, whichever is higher;
d VAT of 10 per cent, paid by the purchaser (VAT on transfer of modest housing and modest condominiums is exempt);
e sales tax on luxury goods of 20 per cent, limited to luxury residences such as luxury housing, condominiums, apartments, town houses and similar for non-strata titles with a building area of 350 square metres or more and for strata titles with a building area of 150 square metres or more;
f land and building tax of not more than 0.3 per cent calculated from the taxable object value, paid annually;
g stamp duty of 6,000 rupiahs;
h PPAT handling fees for land transfers, which are negotiable; and
i state contribution expense, which depends on the size of the land.

iv Finance and security

Under Indonesian law, a mortgage, which is the most common security granted over real estate, is a security right over rights of land, with or without other properties forming an integral part of the land, for the payment of certain debts, and that gives preference over other creditors.

Land rights that can be secured with a mortgage are:
a right of ownership;
b right to cultivate;
c right to build;
d right of use over state land; and
e right of use over right of ownership land.

A mortgage may be pledged over a land right jointly with the building, plant and existing or future property that forms an integral part of that land, owned by the holder of a land right through deed of granting of mortgage. If the building, plant and property are not owned by the holder of the land right, the pledge of mortgage over those objects may only be performed through the signing in the deed of granting of mortgage by their owner (or proxy through a deed). The deed of granting of mortgage must be made before a PPAT. The granting of mortgage must be registered with the Land Office, which will issue a certificate of mortgage as evidence.

If the debtor is in default, the first mortgage holder may sell the object at his or her sole discretion through public auction and recover his or her receivables from the auction. If the grantor of the mortgage (debtor) is bankrupt, the mortgage holder (creditor) is still able to execute his or her mortgage.

VI LEASES OF BUSINESS PREMISES

Leases are regulated by the Civil Code. Under Indonesian law, a lease means an agreement by which one party binds itself to give the other the enjoyment of goods, for a definite period in exchange for payment of a price agreed by the latter party.

While regulated by the Civil Code, two Government Regulations (the Commercial Lease Regulations)[2] also apply to commercial leases.

The law does not stipulate any maximum term for a lease of land or a commercial building lease in Indonesia; however, the parties to a lease must take into account the duration of the lessor's relevant land title. For example, if the land right to be leased is a right to build, the term of the lease should take into account the term of the right to build. If the parties agree to a lease term longer than the land title term, provision for the extension of the land title must be made in the agreement.

With regard to rent and rent increases, the law provides that if there is disagreement on the rent price, the owner or lessee may submit a stipulation of rent price to the housing department. While this procedure is specifically set for use in cases where the lessee does not agree with a rent increase, it is rarely used. The parties generally agree terms regarding rent and rent increase in the lease agreement.

By law, and also usually stipulated in the lease agreement, the lessee may not sublease the property or assign the lease to a third party, unless permitted by the lessor. The lessee has two main obligations: to use the leased property as a good *paterfamilias* would, according to its purpose as set out in the lease agreement, and to pay the rent. If the lessee uses the property for purposes other than those intended, or for purposes such that the lessor may suffer a loss, then this party, according to the circumstances, may request termination of the lease. Further, the lessee shall be responsible for any damage to the leased property during the lease period, unless he or she proves that the damage has occurred without fault. The aforementioned responsibility extends to the lessee's successors or assignees.

Regarding security of tenure, the law clearly states that the lessor must give the lessee peaceful enjoyment of the property during the lease period, and stipulates that the lease agreement is not terminated by the death of the lessor or the lessee. Unless agreed at the time of leasing the property, a lease agreement made prior to the sale of the property does not terminate with the sale.

The Commercial Lease Regulations provide that the termination of a lease may only be performed through an agreement by the parties. If no agreement is reached by the parties on termination of the lease, it may only be performed through a court decision. This provision limits the authority of the lessor to terminate the lease unilaterally if the lessee is in breach of the agreement; therefore, in practice, the lessor requests that the Commercial Lease Regulations provisions be waived.

VII DEVELOPMENTS IN PRACTICE

The following provides a brief summary of new laws directly related to real estate development and investment, and that are influential on the development of real estate law in Indonesia.

2 Government Regulation No. 49 of 1963 as amended by Government Regulation No. 55 of 1981.

i Housing law

The new housing law, which revokes the old law of 1992, was promulgated in January 2011. This legislation stipulates housing and occupancy areas:

a to provide legal certainty on the implementation of housing and occupancy areas;
b to support the synchronisation and development of areas and proportional distribution of residents;
c to improve utilisation of natural resources for housing development in cities and villages;
d to develop all stakeholders in the housing development and occupancy areas;
e to support economic, social and cultural development; and
f to guarantee viable, accessible housing.

One provision of the legislation that created debate among real estate developers specified 36 square metres as the minimum floor area for single and joint houses. This created problems, since many developers construct modest housing with a smaller floor area. However, as this clause was revoked by the Constitutional Court in October 2012, real estate developers may construct and sell houses with a floor area of less than 36 square metres.

A single house, joint house or condominium still in development may be marketed through an officially authorised conditional sale and purchase agreement (CSPA). The CSPA is conditional on:

a land ownership status;
b agreed terms such as location, condition of land, shape, specification, price, facilities, amenities, public utilities, other facilities, delivery time and dispute settlement;
c obtainment of a building construction master licence;
d availability of facilities, amenities and public utilities; and
e the construction of at least 20 per cent of all planned housing. A legal entity is prohibited from delivering or receiving more than 80 per cent of the consideration before fulfilling these conditions. Developers in breach of this provision will be criminally liable and subject to a maximum of one year's imprisonment or a maximum fine of 1 billion rupiahs.

ii Condominium law

The new condominium law, which revokes the old law of 1985, was promulgated in November 2011 and provides that commercial condominiums may be developed by any person, including through foreign investment. However, developers of commercial condominiums must provide public condominiums of at least 20 per cent of the total floor area of the commercial condominiums that are built.

A condominium may be built over a right of ownership, a right to build or a right of use over state land, and a right to build or a right of use over right of management. If the construction of the condominium unit is performed on a right to build or a right of use over right of management, the developer must obtain the right to build or right of use over right of management status before selling the condominiums. As evidence of condominium ownership, a title certificate of right of ownership of condominium will be issued.

A developer may perform marketing prior to the construction provided that the developer already possesses:

a certainty of usage area;
b certainty of land right;
c legalised title of division showing the boundaries of each condominium;
d a building construction licence; and
e a warranty on the construction of condominiums from a bank or other institution.

Everything promised by the developer or its marketing agent is deemed as the CSPA to the parties. The CSPA is made before a notary. The signing of the CSPA is performed after the fulfilment of conditions on:

a land ownership status;
b obtainment of building construction licences;
c availability of facilities, amenities and public utilities;
d construction of at least 20 per cent of the volume that is currently marketed; and
e agreed terms such as location, shape, specification, price, facilities, amenities and public utilities, other facilities and delivery time.

iii Land procurement law

In January 2012, the land procurement law was passed to accelerate the land procurement process in the public interest, while also prioritising economically fair and democratic principles, thereby providing for landowners to receive fair and proper compensation. This law also aims to improve the previous regulations on land procurement, which are outdated and inappropriate.

iv Environmental permit

Issued in February 2012, Government Regulation No. 27 of 2012 on Environmental Permits is the implementation of the law on environmental protection and management that was issued in 2009. Under the Regulation, every business or activity that requires an environmental impact assessment (AMDAL) or an environmental management and monitoring plan must obtain an environmental permit. The environmental permit is a prerequisite to obtaining a business or activity licence. The environmental licence will expire along with the expiry of the business or activity licence. Any person conducting business or an activity without an environmental permit will be liable to conviction and imprisonment for a minimum of one year and a maximum of three years, and a minimum fine of 1 billion rupiahs and a maximum fine of 3 billion rupiahs.

Real estate businesses require an AMDAL according to the size of the housing or occupancy area and the location of the proposed development. The criteria for requirement of an AMDAL for real estate developments are:

a a development of 25 hectares or more in a metropolitan area;
b a development of 50 hectares or more in a large city; and
c a development of 100 hectares or more in a medium-sized or small city.

An AMDAL is also required for offices, places of worship, educational, sport and art centres, and commercial or shopping-centre facilities with a land area of 5 hectares or more, or a building area of 10,000 square metres or more.

v Building ownership evidence

Under current building law and regulations, and the Indonesian land title system, the ownership of land may be separate from the ownership of buildings. By law, buildings must be constructed over land with clear land ownership status, whether it is self-owned or belongs to another party. If the land is owned by another party, a building can only be constructed after obtaining a written agreement to use the land from the landowner. This agreement shall at least set out the rights and obligations of the parties, the land area, location, land boundaries, building function and term of the land use.

The building ownership status is evidenced with a building ownership-evidence letter issued by local government. The ownership of a building may be transferred to another party. If the building owner is not the landowner, the transfer of the right may only be performed upon the approval of the landowner. The Presidential Regulation expected to provide more detailed provisions on building ownership-evidence letters has yet to be promulgated. However, since 2010, Jakarta has issued a local government regulation on building to provide detailed provisions on building ownership-evidence letters.

vi Traffic-impact analysis requirement

The law on traffic and road transport was promulgated in 2009 and its implementing regulation issued two years later. One of the provisions in the law, regarding traffic-impact analysis, stipulates that all development plans for activity centres, housing and infrastructure that will affect security, safety, order and ease of traffic and road transportation require a traffic-impact analysis. The provision of a traffic-impact analysis report is one of the conditions for developers to obtain a location licence and a building construction licence.

vii Green-building requirements

A Regulation on green building specific to Jakarta[3] was issued by its governor in April 2012, and although it is a local government Governor Regulation, it is intended to serve as a national benchmark for green-building requirements covering new and existing buildings; however, not all types of buildings are required to comply. The Regulation governs the following types and sizes of buildings in Jakarta:

a condominiums, offices, shopping centres and buildings with more than one function and with a floor area greater than 50,000 square metres;

b hotels and health-care facilities with a floor area greater than 20,000 square metres; and

c education facilities with a floor area greater than 10,000 square metres.

3 Governor Regulation of DKI Jakarta No. 38 of 2012 on Green Building.

Broadly, the technical aspects of the requirements cover energy efficiency, water efficiency, indoor air quality, land and waste management and construction practices. Moreover, the technical requirements for existing buildings relate to energy efficiency and conservation, water efficiency and conservation, indoor air quality and operational or maintenance management.

The local government will not issue a construction licence or feasible-use certificate for the relevant building if a developer fails to comply with the Green Building Regulation.

VIII OUTLOOK AND CONCLUSIONS

Indonesia's reform programme, ongoing since 1998, continues, with many new laws promulgated, and many proposed and still to be debated in the future. The House of Representatives has set out an ambitious national legislative programme that includes 247 bills to be deliberated and passed before the elections in 2014. Among these, the House of Representatives plans to pass draft bills on rights of land, property ownership and agrarian and land reform. Specifically regarding the draft bills on land, the House will stipulate the use of space above and beneath the land, agrarian reform and the formation of a court for the resolution of disputes related to land. Other than these draft bills, the House is also discussing draft bills on the acknowledgment and protection of customary communities rights.

Chapter 16

IRELAND

Kevin Hoy[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

The Republic of Ireland is a unitary state with a common law legal system, a written constitution and a parliamentary democracy. Primary legislation is in the form of Acts of the Oireachtas (the Irish parliament) and secondary legislation is by statutory instruments, which may be issued by authorised bodies such as government ministers and various other entities, such as the Property Registration Authority and the Law Society of Ireland.

i Ownership of real estate

The two most common forms of title are freehold (perpetual) and leasehold (for a specific term of years). The investment market is characterised by the landlord owning the freehold and the tenant having the occupier's interest under a lease. Some properties, particularly in urban areas, have very long leasehold titles (e.g., 900 years). While not strictly speaking freehold, the investment market regards these as similar to freehold. Leases were used as well in certain commercial contexts (e.g., tax-based financings), and also because of concerns about whether positive covenants would bind subsequent freehold owners. The latter has been confirmed as being effective by the Land and Conveyancing Law Reform Act 2009 (the 2009 Act).

Previously, the most common form of structure in an office or commercial development was a lease of at least 25 years with an upward-only rent review every five years. Since 28 February 2010, new leases may not have upward-only rent reviews. Residential tenancies tend to be for far shorter periods (usually a year). The residential rental sector is subject to more regulation than the commercial sector, with the statutory

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Private Residential Tenancies Board operating a national tenancy registration system and resolving disputes.

ii System of registration

Ireland has two systems: Registry of Deeds and Land Registry. While both are operated by the Property Registration Authority, the consequence of the registration in each is quite different. The Registry of Deeds dates back to the 18th century and amounts to a mere register of documents. In other words, registration does not give any indication as to the effect of the documents and the quality of one's title. The Land Registry was set up in the 19th century to enable the government of the day to acquire the often-complicated titles of indebted landlords and redistribute the property among mainly agrarian tenants. The Land Registry record enabled everyone to start again with the tenant getting a clear state-guaranteed title. The Land Registry record includes a map, the name of the legal owner and information about certain third-party rights. Some interests, such as leases with fewer than 20 years to run, cannot be registered in the Land Registry, and some matters (e.g., pipelines) can affect title without being registered.

The policy of successive governments has been to have as much land registered in the Land Registry as possible, with a view, in part, to enabling e-conveyancing. Since June 2011, all transactions for value result in the purchaser applying for registration of the title in the Land Registry even if up to then the title has been Registry of Deeds. If the disposition is voluntary in nature (e.g., a gift or a conveyance on the appointment of new trustees), there is no obligation to register a Registry of Deeds title in the Land Registry. The government hopes that, over time, all property in the state will consist of Land Registry title.

In 2012 the Property Services Regulatory Authority (the PSRA) commenced its work, and in 2013 it started the Commercial Leases Database and the Residential Property Price Register. Local Property Tax started in May 2013, and includes a valuation register compiled by the Revenue Commissioners (but this is unlikely to be published). Water charges will come in for the residential sector in 2014.

iii Choice of law

The private international law principles that Ireland uses are influenced to a large degree by the law applicable in England and Wales and international treaties. The usual approach to property matters is that the *lex situs* applies (the law of the place where the real estate is located). There is no prohibition on endeavouring to deal with Irish real estate matters in a document governed by the law of another jurisdiction, but to avoid any issues on registration or enforcement it is advisable to have an Irish law document to govern Irish real estate matters.

II OVERVIEW OF REAL ESTATE ACTIVITY

2013 has seen optimism reappear. The rating agencies continue to be more positive, and Ireland has successfully exited the EU/IMF bailout on schedule. The National Asset Management Agency (NAMA) is continuing to release Irish assets into the market and to provide stapled finance in some cases. Stamp duty on commercial property at 2 per cent, and the extension of a seven-year capital gains tax holiday to property bought up to the end of 2014 and held for seven years, will encourage transactional activity. While Ireland's primary deficit still needs work, the major risk now seems to be external, and particularly what happens in the rest of the eurozone. Most Irish people aspire to own their own home, but although the residential rented market constitutes a minority of the overall housing stock, its market share is growing. Foreign investors are becoming substantial owners of residential assets. For example the Canadian firm CAPREIT bought four apartment blocks in various parts of Dublin in 2013.

There are positive economic indicators, and international commentators have noted that Ireland is performing well.

Irish banks were heavily exposed to property loans. One of the main government responses to the crisis was the establishment of NAMA, which took over most land loans, development loans and related loans extended by Irish banks. This transfer took place regardless of the location of the asset, although the legislation cannot override any relevant law in the jurisdiction where the property is located.

Some foreign banks (such as RBS, Lloyds Bank and Rabobank) operate in Ireland. As a result, some Irish assets are funded by foreign banks and are not within NAMA's ambit, while some foreign assets are funded by Irish banks and therefore are in effect controlled by NAMA. NAMA has been encouraging borrowers to sell assets (mainly abroad but increasingly in Ireland) to try to rebalance the property funding situation. Irish banks are shrinking their balance sheets; this means they have less money to lend and what money they do have may be tied up in refinancing existing commitments. Some commercial property financing had recommenced in 2012, and 2013 saw the beginning of development debt funding, albeit at low loan-to-value ratios. Bank of Ireland has been particularly active in the commercial property sector. Office activity has increased as well with interest from home and abroad. The Green Property venture, Green REIT plc, acquired a portfolio of commercial properties from Danske Bank, IPFUT (an Irish pension fund) has been active in acquiring office blocks again and many investors are seeking further opportunities. Banks (both Irish and foreign) continue to sell portfolios of Irish property loans and Irish real estate.

III FOREIGN INVESTMENT

Ireland imposes no bar on foreign investment (other than any restrictions that may be required from time to time by UN sanctions). In fact, foreign direct investment is one of the country's success stories. As a member of the European Union, Ireland cannot discriminate between its own citizens and those from other Member States exercising rights of establishment or free movement. Restrictions that had existed pre-EU membership have been repealed, although one may still see (and can safely ignore) references to these provisions in title documents. Foreign direct investment is a major part of the Irish economy, with many US multinationals basing their European headquarters in Ireland. Ireland was ranked as the best country in the world in which to do business by *Forbes Magazine* in December 2013.

IV STRUCTURING THE INVESTMENT

The use of various tax structures will include close scrutiny of applicable double-taxation agreements if the transaction is international. Property-based tax incentives played a role in fuelling asset price increases over many years. These reliefs will expire over time. The real estate investment trust (REIT) structure was introduced in 2013 as part of an overall review of what Ireland needs to do to encourage foreign investment. To date, two Irish REIT's have been formed.

Ireland operates a system of 12.5 per cent corporation tax on trading income. Passive investment income is charged at 25 per cent. Capital gains tax applies (subject to an inflation protector) at a rate of 33 per cent. There is also a transaction tax known as stamp duty. There will be no capital gains tax imposed for the first seven years of ownership on any increase in market value of a property that was bought between 6 December 2011 and 31 December 2014, provided that the property is held for at least seven years. The rate of stamp duty for commercial property has been reduced to 2 per cent.

Investors take different approaches to which legal structure to use depending on their particular circumstances. One may decide to hold the property directly in one's own name or through a corporate entity such as a limited liability company. If more than one person is an owner then one may either have co-ownership, or a partnership in which property ownership is the business or a limited partnership in which limited partners are not allowed to participate in the management of the partnership business. More sophisticated investors may wish to avail of property unit trusts, regulated property funds and unregulated property funds. While an Irish REIT is a corporate entity (it must be a plc quoted on the main exchange in an EU country) it has the benefit of particular tax treatment, unlike most corporate vehicles. Sometimes a joint venture arrangement will be documented as a matter of contract rather than setting up a separate joint venture vehicle. As with any legal arrangement, appropriate articulation of the parameters of the agreement is very important, as the document should reflect each party's understanding of what the arrangement will be and how any disagreements will be resolved.

V REAL ESTATE OWNERSHIP

i Planning

Any development (which includes physical work as well as change of use) requires planning permission from the local planning authority. A fast-track process with An Bórd Pleanála (the Planning Board) applies in the case of strategic infrastructure. Development must also comply with building control, fire regulations and disability access requirements. If dissatisfied with a local planning authority decision, one may appeal to An Bórd Pleanála. In 2014, the Docklands area of Dublin should benefit from a strategic development zone authorisation, which will result in speedy planning decisions by Dublin City Council and no possibility of appeal to An Bórd Pleanála.

ii Environment

The Environmental Protection Agency deals with environmental activities and operates a licensing and enforcement system. Contaminated land that is not being used is not subject to any specific legislation, although general EU law applies and the Derelict Sites Act notices may be served if buildings are in a bad state of repair. This may result in the owner having to repair the property or having it taken over by the local authority. To develop land that has been contaminated, substantial remediation works may be needed, and this is often dealt with in the conditions imposed by the planning permission.

iii Tax

Value added tax (VAT) on real estate is a complicated area made more difficult by the proliferation of enforcement sales where the bank does not know the VAT history of the property. The VAT rate is 23 per cent, but a rate of 13.5 per cent may apply in limited circumstances.

Stamp duty applies at a rate of 1 per cent (if the property is residential) on market value of up to €1 million and at 2 per cent above that amount. The rate is 2 per cent on commercial property. Stamp duty also arises in relation to commercial leases (1 per cent of the rent). The system has been substantially simplified and the rates lowered in recent years.

Local government is funded through a combination of central funds, local property tax (see below) and commercial rates. The local authority strikes a rate each year that when multiplied by the rateable valuation gives the rates bill. There are some reliefs for vacant property. Rates apply to commercial property.

Local property tax (LPT) started in Ireland in 2013, and is in reality a residential property tax, affecting all residential property in the state. Landlords are liable to pay the tax on rented property (unless the lease is for more than 20 years). As a transitional measure, only half the tax was payable in 2013, and the full amount of tax will be due in 2014. LPT is an annual tax and a charge on property. The tax rate is 0.18 per cent up to €1 million and 0.25 per cent thereafter.

The first valuation date of 1 May 2013 resulted in a valuation that applies to the end of 2016. Therefore, if there is an uplift in the property market generally or if improvements are made to the property, the impact of such on the value of the property will not flow through to the LPT bill until 2017.

The household charge was abolished as of 1 January 2013, but any arrears will continue to be a charge on the property. Non-principal private residence (NPPR) tax will continue during 2013 but will then be abolished. Unpaid NPPR will continue to be a charge on the property.

iv Finance and security

A charge can be created on land and buildings; this gives priority (once registered) against claims by any other party. One can also create floating security over general assets (which may include real property). This has a lower priority than fixed charges and also may require extra steps (such as registration in the Land Registry on crystallisation) to be fully effective in an enforcement situation.

VI LEASES OF BUSINESS PREMISES

Because of the huge differences between the business context now and even seven years ago, the nature and content of commercial leases has been changing. Short-term leases (for up to five years) tend to provide that the tenant is responsible for the interior of the premises and the landlord is responsible for everything else, including the structure; the tenant supposedly pays a higher rent for this level of comfort. Longer-term leases usually provide that the tenant is responsible for everything.

The term of long-term commercial leases was 35 years, then became 25 years, then reduced to 20 years, and now can be anything between 10 and 20 years. Break clauses, which may enable a tenant to cancel a lease before the end of the term, and rent-free periods of between six and 12 months, have become more common. Leases usually include many restrictions on what the tenant can do, such as specifying the permitted use and obliging the tenant to contribute towards the ongoing operational costs in the case of any multi-occupancy development (such as an office block or shopping centre).

How rent is reviewed will be determined in accordance with the lease provisions. Leases created before March 2010 may have upward-only rent review clauses so that even if market rates fall, the previous rent will continue to apply. While there has been a ban on upward-only rent review clauses since 28 February 2010, clever drafting means that in some cases only the landlord may trigger a review; it remains to be seen whether the courts will give effect to such clauses.

Turnover rents and consumer price index (CPI) rent clauses are gaining in popularity. The legislation that outlawed upward-only review clauses did not carve out CPI provisions, therefore there is a risk that CPI clauses are not effective.

Multi-occupancy developments tend to have a management company to maintain common areas and provide common services, for which tenants pay a service charge.

The government's legislative programme for 2014 includes a new Landlord and Tenant Bill, which will consolidate and update all existing legislation (although this had been scheduled to appear in 2013).

VII DEVELOPMENTS IN PRACTICE

The past few years have been traumatic for the Irish property market. Values fell by 60 per cent in general and by as much as 90 per cent for land with future development potential. Various indices appear to indicate that prices are stabilising, with increases in 2013 in Dublin in particular. Lack of credit has restricted the emerging recovery, and it can be envisaged that there will be a shortage of modern office facilities, particularly of larger space, because speculative development is not happening. While office vacancy rates are around 20 per cent, Ireland's continuing success in attracting foreign direct investment, especially in the technology area, creates ongoing demand for top-quality office space.

i NAMA

NAMA owns the loans of Irish banks for property and related matters but is not the owner of the underlying assets (although it can trigger a statutory process to become the owner in specific circumstances). The transfer process has included very extensive diligence. The relevant legislation fixed the acquisition price based on the market value of the underlying assets in November 2009. Because property values continued to fall, NAMA has since faced substantial paper losses (comparing asset value with acquisition price). It has, however, announced plans to be in profit by 2020 when its mandate expires. The recent increases in prices in parts of the country will facilitate this.

One of the basic principles of establishing NAMA was that it would be in a position to hold property in the longer term, thereby allowing for a recovery in market value. It has been working with borrowers to ascertain whether they have viable business plans, what the framework might be for orderly disposal and whether any transactions previously undertaken should be unwound. While NAMA has placed numerous entities into receivership, some business plans have been agreed. An element of its work has been to investigate transactions with connected persons. Some borrowers have been encouraged to unwind transactions with their spouses and children to make more assets available to NAMA for enforcement or repayment.

NAMA has recruited a substantial number of expert personnel to enable it to deal with the myriad matters that require its attention as the effective controller of shopping centres, housing estates, apartment complexes, office blocks, retail parks, warehouses, derelict sites, half-completed developments and fields. Its decision-making process has, perhaps inevitably, been much slower than market participants would like, but hopefully this investment in staff and systems means a more streamlined process will emerge.

Asset disposals have largely been outside Ireland. There were a number of disposals in 2013, and the market anticipates an increase in volume in 2014. NAMA has also funded some developers to complete projects.

ii Lease market

Consider the example of a lease that started in 2006 with rent reviewed in 2011. If the 2011 market rent was higher than the 2006 contractual rent, the 2011 market rent would apply until the next review in 2016. If, however, the 2011 market rent was less than the 2006 contractual rent, the 2006 contractual rent would continue to apply until 2016. Upward-only rent reviews had become a standard part of Irish commercial property life.

Upward-only rent reviews in new leases were abolished from 1 March 2010. A two-tier market emerged with older upward-only rent review leases being worth more to an investor (and less to a tenant) than a newer lease of the same property on the same terms without an upward-only rent review. Landlords have employed various methods to overcome the prohibition, such as having the landlord – rather than the tenant – trigger the review, so that if market value were to fall, the landlord would not activate the review and the rent would stay the same.

In December 2011, the current government announced that, because of constitutional difficulties, it would not retrospectively abolish upward-only rent reviews. Substantial activity recommenced in the investment market in 2012, and this strengthened in 2013. While it might be unsettling for investors that retrospective legislation could have been contemplated, ultimately this must be a reassuring demonstration that the constitutional protection of private property is effective in Ireland.

iii Foreign bank moves

As well as Irish banks such as Bank of Ireland, AIB, Irish Nationwide and Anglo Irish Bank, a number of foreign banks were also very active in the Irish property market (such as Ulster Bank (RBS), ACC (Rabobank) and Bank of Scotland (Ireland) (now Lloyds)). As mentioned previously, NAMA now controls most property and related loans of Irish banks. Some of the foreign banks have state shareholders in their home country, and others continue to operate in the private sector. All have been quicker to move to enforce in Ireland than their Irish counterparts.

There has been a substantial amount of litigation regarding banks' powers of enforcement. The conveyancing legislation was updated in the 2009 Act. Because of a drafting oversight, the old law was not effectively continued for security granted before the new law came into effect, but the government has remedied this. The court protection system, known as examinership (see Section VII.iv, *infra*), has generated interesting case law on the circumstances in which an examiner can seek to disclaim an onerous lease. In December 2013, examinership became available in a less expensive format, and it will be interesting to see if retailers avail of this in 2014. On enforcement generally, the courts have adopted a straightforward approach: the borrower owes the money and a defence must be substantial to delay summary judgment.

Allsop, the UK-based auction house, has organised a number of auctions for Lloyds. The use of online tracking of bids and the disclosure of maximum reserved prices combined with a very effective publicity campaign have resulted in very successful auctions in terms of properties sold. Market observers were pleasantly surprised at the level of interest, the number of cash buyers and the sustained nature of that interest. One might have thought that after a successful first auction there might be difficulties, as the 'mattress money' would be used up, but instead each auction has been a success and Lloyds plans further auctions in 2014. These auctions are also being increasingly used by other vendors.

One fundamental constraint in the market is the shortage of bank finance. NAMA and some banks occasionally provide, in effect, vendor financing whereby purchasers are facilitated in acquiring assets by the provision of loans by the enforcing institution.

iv Insolvency

For corporates, liquidation, receivership and examinership (a form of standstill that has some similarities with the US Chapter 11 process) exist. Personal bankruptcy rules had been little used because the term of bankruptcy has been at least 12 years. This resulted in some high-profile cases of borrowers emigrating to the UK (which has a one-year period), being declared bankrupt there, and then seeking to assert that bankruptcy scheme for their business dealings in Ireland.

Sean Quinn, who at one time was regarded as being the wealthiest person in the country, was declared bankrupt in Belfast in Northern Ireland. IBRC (as Anglo Irish Bank has been renamed) challenged this on the basis that Mr Quinn's primary connection was with the Republic of Ireland, and that therefore the laws of the Republic of Ireland should apply. The Belfast bankruptcy was set aside, and Mr Quinn has since been made bankrupt in the Republic of Ireland.

Many expressed the view that Irish bankruptcy law was too onerous because of the length of the term (12 years), and that this was a serious impediment to commercial risk-taking. The discussion revolved around how to treat the honest person whose business fails. The government implemented the Personal Insolvency Act in 2013. The new legislation introduced new concepts such as the debt relief notice, the debt settlement arrangement and the personal insolvency arrangement. Bankruptcy will end after three years, and the government has set up an Insolvency Service to deal with an anticipated 24,000 applications in a full year. There were only 30 bankruptcies in 2011.

v Apartments

Multi-unit and individually owned living accommodation is a relatively new phenomenon in Ireland. Legislation came into force in 2011 (the Multi-Unit Developments Act 2011) to try to better regulate this important sector of the residential accommodation market. The statute seeks to address difficulties that arose regarding transfer by the developer of common areas to a management company, ongoing control by the developer of the management company and the provision of services by the developer to a management company. Some developers had retained an apartment and thereby continued to retain control of the common areas. While elements of the new law will take time to implement in terms of developing a common approach among practitioners, the thrust of the legislation is to be welcomed and should help modernise the law relating to apartment owning in Ireland.

vi Information

The government has implemented legislation that requires the publication of relevant information. Details of residential sales are available from the Residential Property Price Register produced by the PSRA, but at the moment there is no register of the value of commercial property transactions, so ascertaining market value can be difficult. The commercial register has lease details, but not sales information. The PSRA is also the new regulatory authority for estate agents (another innovation) and has the task of operating this register as well as taking over the functions of the Private Residential Tenancies Board. Better statistical information should enable vendors and purchasers to make more informed and accurate decisions on property investment.

VIII OUTLOOK AND CONCLUSIONS

In 2013, the property market in Ireland showed signs of some growth and the beginnings of normal activity (e.g., house building). As values have fallen so much, there are still bargains for the long-term investor. NAMA disposals and bank funding will encourage individual buyers back into the market. International investors have become important participants.

Chapter 17

ITALY

Alessandro Balp[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

The Italian Civil Code provides for a limited number of rights *in rem* over real estate and the parties may not contractually create additional rights *in rem*.

The main right is ownership, granting its holder the full right to use and dispose of the property. All other rights *in rem* are limited in scope and grant to their holders only one or more of the attributions of the full property right. Other common rights *in rem* are:

a surface right, granting its holder the right to build and maintain a building over the property of a third party;

b right of usufruct, granting its holder the right of use of and the benefits over a third-party property; and

c easements, which impose a burden, or a limitation of the rights, over a property for the benefit of another property (e.g., a right of way; water right; right of view; or a limitation in the building capacity).

Other less common rights *in rem* are the *uso* and *abitazione* (both lesser forms of the right of usufruct) and the *enfiteusi*, which has many similarities to the full property right. Rights *in rem* are registered in the land registers and are enforceable against third parties.

The parties are free to establish contractual rights over real estate (e.g., lease agreements, pre-emption rights or rights of first refusal). Contractual rights are effective between the parties, but their enforceability towards third parties is limited.

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ii System of registration

Under Italian law, real estate assets must be registered with the cadastral register and rights related to real estate must be recorded in the land registers.

The cadastral register is kept by the real estate tax agency. Registration in the cadastral register is required for tax purposes but does not attest ownership. The cadastral register classifies real estate assets by municipality, and shows for each property the relevant cadastral data and the cadastral income that forms the basis for the application of real estate taxes.

All contracts for the transfer of the ownership and other rights *in rem* over real estate, certain long-term leases (exceeding nine years) and guarantees over real estate assets must be registered with the land registries. The registration ensures the enforceability, and gives to the right holder priority with regard to third parties. The absence of the registration does not impair the validity of the transfer but renders it unenforceable against any third party that has previously registered a conflicting right over the property.

The Italian system does not provide for any form of state guarantee of title to real estate; however, the notary public entrusted with the sale will perform the routine title checks and the land registration system ensures that title to real estate will be properly registered.

II OVERVIEW OF REAL ESTATE ACTIVITY

In 2013, Italy witnessed a sharp increase in the real estate activity compared with the 2011–2012 period, with a significant growth in volumes and the overall number of sizable transactions.

The main driving force behind this turnaround has been the rise in the interest of foreign investors that have significantly increased their presence on the Italian market and are showing a growing appetite, especially for office and commercial real estate.

Having shunned the Italian real estate market in 2011–2012, foreign investors have made an impressive comeback on the Italian market in 2013, accounting for about an 80 per cent share of the institutional real estate market – a percentage not seen since 2007.

The main foreign investors have been large international property funds, sovereign investors, insurance companies and family offices.

With the easing of the eurozone situation and a gradual pickup in economic activity and consumer confidence, the Italian market is becoming a viable alternative for institutional investors, as it offers significantly more attractive yields compared with other core European markets.

The credit market remains very tight – another factor giving an edge to foreign investors, who have easier access to international finance markets, over domestic players.

III FOREIGN INVESTMENT

Italian law does not impose any significant restriction on foreign ownership of real estate. EU nationals may freely purchase real estate as domestic citizens. Purchase of real estate by non-EU or non-EFTA nationals is subject to a reciprocity principle (the foreign national is subject to the same restrictions that are applied to Italian nationals by its own country).

IV STRUCTURING THE INVESTMENT

Several possible investment structures exist with which to invest in Italian real estate, some of which are outlined below.

i Corporate vehicles

Rental income and capital gains assets sales are taxed at the ordinary corporate tax rates: corporate income tax (IRES) at 27.5 per cent and regional tax (IRAP) at 3.9 per cent. Special rules apply to the deduction of interests (30 per cent EBITDA (earnings before interest, taxes, depreciation and amortisation) limitation on interest deductions, subject to exemption for debt that is secured by mortgage).

ii Partnerships

Partnerships in Italy are transparent for tax purposes, and income deriving from real estate investments is directly taxed in the hands of the partners irrespective of its distribution. The 30 per cent EBITDA limitation on interest deduction does not apply to Italian partnerships.

iii Real estate funds (REIFs)

REIFs are not subject to IRES and IRAP but only to local property taxes. The tax regime applicable to investors in Italian REIFs varies depending on the nature of the fund: investors in institutional funds are generally subject to a 20 per cent withholding tax on income distributed by the fund, while for non-institutional funds, the fund's income is directly attributed to the investors holding 5 per cent or more of the fund's units, irrespective of its distribution.

iv Listed real estate investment companies

To qualify as a listed real estate investment company (SIIQ), the company must be listed on a stock exchange, no shareholder may hold (directly or indirectly) more than 51 per cent of voting and profit rights, and at least 35 per cent of shares must be owned by shareholders, each individually holding (directly or indirectly) no more than 2 per cent of voting and profit rights. To maintain the SIIQ status, each year the company shall distribute at least 85 per cent of its profits deriving from leases and investments in at least 95 per cent-owned real estate subsidiaries. Italian SIIQs benefit from total tax exemption on income deriving from leasing activity and from investments in 95 per cent-owned real estate subsidiaries (exemption from both IRES and IRAP).

V REAL ESTATE OWNERSHIP

i Zoning and planning

Under Italian law, buildings must comply with local planning regulations. Furthermore, pursuant to Legislative Decree No. 380/2001 (as amended), the construction of new buildings and the carrying out of significant works on existing buildings are subject to an authorisation issued by the local municipality (i.e., declaration of beginning of activity or building permit, depending on the kind of works to be carried out).

Any work carried out without the relevant authorisation, as well as any work carried out that is not in compliance with the authorisation issued, is subject to a specific sanction that may result, *inter alia*, in:

a fines being imposed on the building's owner;
b orders to carry out alterations on the building;
c the demolition of the building (or part of it); or
d the non-transferability of the building.

Fitness-for-use certificate

Properties located in Italy need to be granted a fitness-for-use certificate by the local municipalities. The fitness-for-use certifies the health and safety, hygiene and energy-saving conditions of the building and its installations.

Fitness-for-use certificates are governed by Presidential Decree No. 380/2001 and regulations issued at the local level.

A fitness-for-use certificate must be applied for after the completion of a new building being built, an existing building being totally or partially reconstructed or new portions of an existing building being built, or the health and safety, hygiene and energy-saving conditions of the premises being modified.

Normally, fitness-for-use certificates are not issued in the absence of:

a the application seeking registration of the building with the cadastral office;
b a declaration attesting that the works have been completed in compliance with the approved projects;
c a declaration attesting the compliance of the installations with the applicable legal requirements;
d a declaration attesting to the compliance of the building with the regulations on the removal of architectural barriers;
e the energy-saving certificate; and
f the static stability test.

Fitness-for-use certificates can be issued formally and also by way of silent approval. More specifically, if the municipality does not issue the certificate within a fixed time (i.e., 30 or 60 days) from the application, the certificate is deemed granted provided that the applicant has completed all the required documents. In a case of non-compliance, the owner of the building may be liable to monetary sanctions, and may be obliged to perform the construction or refurbishment works necessary to make the building fit for use. In addition, the tenant may be prevented from using the premises until the building is fit for use. A building may be lawfully transferred even in the absence of a valid fitness-for-use certificate (unlike the case where the building permit is missing).

Fire prevention certificate

Depending on their characteristics, real estate assets may require a fire prevention certificate. The person bound to obtain such certificate is either the owner, if the fire prevention certificate is required because of the structural characteristics of the property and of its common parties; or the tenant, if the fire prevention certificate is required in light of the activity carried out at the property. Lack of the fire prevention certificate may result in monetary and criminal sanctions, as well as in the obligation to undertake the works necessary to obtain the certificate. Furthermore, the competent authority could restrict the use of the premises until the certificate has been granted.

ii Tax

The transfer of real estate assets may in principle be subject to the following indirect taxes:

a value added tax (VAT);
b registration tax;
c mortgage tax; and
d cadastral tax.

The application of these indirect taxes depends on several conditions. Generally speaking, where the seller is an individual or an entity not carrying out a business activity relevant for VAT purposes, the sale of real estate properties is not subject to VAT but to registration, mortgage and cadastral taxes (the rate of which may vary from €168 to 15 per cent of the value of the property). In contrast, if the seller is an individual or an entity carrying on a business activity relevant for VAT purposes, the sale is subject to VAT (generally at 21 per cent, although a 4 per cent or 10 per cent rate is applicable under certain circumstances) and to registration, mortgage and cadastral taxes at the fixed rate of €168 each.

A more favourable regime is provided in the case of contribution of real estate assets to real estate investment funds, if certain conditions are met. In particular, the favourable tax regime applies if the contribution includes multiple real estate assets and if the assets being contributed are mainly leased to third parties at the time of contribution.

iii Finance and security

Real estate financing is usually granted as a *mutuo fondiario* under Article 38 et seq. of the Italian Banking Act,[2] which provides for a special regime applicable to medium and long-term loans (i.e., loans lasting for at least 18 months and one day) granted by Italian banks or Italian branches of EU passported banks and secured by a first-rank mortgage over the property.

In addition, to qualify for the *mutuo fondiario* regime, the loan-to-value ratio of the loan (i.e., the ratio between the amount of the loan and the value of property subject to the first-ranking mortgage in favour of the lenders) must not exceed 80 per cent.[3]

2 Legislative Decree No. 385/1993.

3 See Article 38(2) of the Banking Act and implementing resolutions.

From the lender's perspective, the advantage of structuring a financing as a *mutuo fondiario* is the higher degree of protection from the risk of insolvency of the borrower, as payments effected by the borrower under a *mutuo fondiario* are not subject to clawback actions under Article 67 of the Italian Insolvency Law,[4] and mortgages granted to secure a *mutuo fondiario* are not subject to clawback actions if registered in the relevant cadastral register at least 10 days before the declaration of insolvency of the mortgagor (while mortgages granted in respect of loans not subject to the *mutuo fondiario* regime are subject to a six-month – or one-year, depending on the circumstances – clawback period). From the borrower's perspective, the main advantage of the *mutuo fondiario* is that, in the event of a delay in loan payments, the rights of the relevant lenders to accelerate the loan is subject to certain restrictions (i.e., in broad terms, the lender will be entitled to accelerate the loan if a payment delay occurs at least seven times).

If the loan does not qualify under the *mutuo fondiario* regime, it will be subject to the general provisions of the Italian Banking Law and the Civil Code concerning financing and related security.

The typical security package securing Italian real estate financing includes, in addition to the mortgage:

a the assignment by way of security (or pledge) of the receivables arising from lease agreements entered into in relation to the property and related guarantees securing the lessee's obligations under the relevant lease agreements;

b the pledge over the bank accounts of the borrower (most notably the accounts where the lease receivables of the borrower are to be paid);

c the assignment by way of security (or pledge) of the receivables arising from the interest-hedging agreements entered into in respect of the loan;

d the loss payee clause issued by the relevant insurer in respect of the property; and

e depending on the characteristics of the borrower, a pledge over share capital of the borrower or some form of parent company guarantee.

VI LEASES OF BUSINESS PREMISES

Commercial lease agreements (i.e., agreements for industrial, commercial, leisure, service, professional, and other similar activities) are governed by the provisions of Law No. 392 of 27 July 1978 (the Lease Act) and by Article 1571 et seq. of the Civil Code.

The provisions of the Lease Act significantly reduce the ability of the parties to shape the terms of the lease agreements, which are substantially predefined by law in several material respects. Any provisions limiting the contractual terms set by law or introducing terms favouring the landlord in violation of the Lease Act are null and void.

i Duration and renewal of lease agreements

Pursuant to Articles 27 and 28 of the Lease Act, commercial lease agreements have a minimum compulsory duration of six years (nine years for properties for hotel use) and, upon the first expiry, are automatically renewed for a further six years (nine years for

4 Royal Decree No. 267/1942.

properties for hotel use), unless terminated by either party with 12 months' prior written notice (18 months' notice for properties for hotel use).

Articles 27 and 28 set the minimum duration applicable to commercial lease agreements and, therefore, the parties are free to agree upon longer lease terms (up to a maximum limit of 30 years as provided for by Article 1573 of the Civil Code).

The right of the landlord to terminate the lease agreement upon expiry of the first six years (nine years for properties for hotel use) term is limited to very specific circumstances expressly set out by Article 29 of the Lease Act (e.g., conversion of the commercial premises to use as a dwelling for the landlord or his or her family, use for the running of the landlord's business, demolition or total refurbishment of the premises).

After the expiry of the second six-year term (nine years for properties for hotel use), the lease agreement is automatically renewed for six (or nine) years, unless terminated by either party with 12 months' prior written notice (18 months' notice for properties for hotel use). In the latter case, there is no further restriction on the landlord's right to terminate the agreement.

Where a lease agreement is renewed automatically pursuant to Articles 27 and 28 of the Lease Act, the terms of the lease agreement (rent included) remain unchanged. In this respect, a provision whereby the rent is automatically increased upon any automatic renewal of the lease agreement would be considered null and void for violation of Articles 32 and 79 of the Lease Act (see Section VI.ii, *infra*). On the other hand, upon final expiry or valid early termination of the lease agreement, the parties are free to renegotiate a new lease agreement upon new terms and conditions very different from those formerly in force, including the provision for a higher rent.

ii Rent and rent adjustment

The parties to a commercial lease agreement can freely determine the amount of the initial rent.

Article 32 of the Lease Act provides that the parties to a lease agreement can agree upon the annual rent increase or adjustment on the basis of the percentage variation of the consumer price index for families of workers and employees as calculated by the Italian Central Statistics Institute for the preceding year (the ISTAT rate).

Pursuant to Article 32, such increase or adjustment cannot exceed 75 per cent of the annual variation of the ISTAT rate, except for lease agreements with a duration exceeding the minimum duration provided by the Lease Act (i.e., six plus six years, or nine plus nine years for properties for hotel use). Accordingly, a contractual clause providing for an increase in the rent of an amount higher than 75 per cent of the annual variation of the ISTAT rate would be deemed null and void by an Italian court, and the tenant would be entitled to claim restitution for any excess sum paid. Lease agreements having a duration exceeding the minimum duration set out by the Lease Act may provide for a rent adjustment up to the entire variation of the ISTAT rate.

According to the prevailing case law, the parties may also provide for rent increases on grounds other than inflation adjustment based on the ISTAT rate, if such increases are linked to objective and non-discretionary criteria and, in particular, if the rent adjustment criteria are objective and predetermined in the lease agreement (and are therefore not left to the discretion of the lessor) and the provision does not represent a means to circumvent the statutory limitations on inflation adjustment.

Pursuant to Article 11 of the Lease Act, the rental deposit to be paid by the tenant cannot be higher than three months' rent. By the end of each contractual year, the landlord has to refund the tenant with the legal interest (i.e., the interest periodically fixed by law) accruing on the rental deposit.

iii Early termination by the tenant for material circumstances

Article 27 of the Lease Act provides that, notwithstanding any provision in the lease agreement to the contrary, the tenant to a commercial lease agreement has a statutory six-month prior-notice termination right due to material circumstances. Pursuant to Article 79 of the Lease Act, this provision cannot be amended, nor can its application be excluded by the parties.

iv Sublease

According to Article 36 of the Lease Act, the tenant can sublet the premises or assign the lease agreement, even without the landlord's consent – by giving the landlord registered notice to this end – provided that the business operated by the tenant in the premises is jointly leased or transferred (as the case might be). The landlord may oppose the sublease or assignment within 30 days of receipt of the tenant's communication, but only for material reasons.

v Sale of the leased premises

Article 7 of the Lease Act states that any clause providing the termination of the lease agreement in the case of sale of the property is null and void (*emptio non tollit locatum*). Sales of property interests do not affect, as such, the lease agreement.

vi Maintenance works and relevant costs

Pursuant to Articles 1576 and 1609 of the Civil Code, the landlord is responsible for the necessary costs of maintaining the premises, including any repairing and fitting costs. Such costs do not include the ordinary minor maintenance costs relating to deteriorations due to the use of the leased premises by the tenant, which are borne by the tenant. In addition, pursuant to Article 9 of the Lease Act, the tenant shall bear some additional charges arising from the supply of common utilities or common services (e.g., cleaning, ordinary maintenance of the elevator, cleaning of cesspools, supply of water, electricity, heating and air conditioning). Pursuant to the ministerial report to the Lease Act, any other cost (i.e., expenses of the common parts, such as the manager's salary) must be borne by the landlord. Italian case law has, however, clarified that the above-mentioned provisions can be amended by the parties, and a different allocation of maintenance expenses can be agreed.

If the let premises need repair works, Article 1584 of the Civil Code provides that, if the period during which the repair works are carried out exceeds one-sixth of the duration of the lease agreement and, in any case, lasts for more than 20 days, the tenant is entitled to a reduction of the rent in proportion to the duration of the entire period of repairs and the effect on enjoyment of the premises.

Other indemnities are provided for by Articles 1592 and 1593 of the Civil Code, concerning, respectively, improvements and additions to the leased premises.

According to Article 1592 of the Civil Code, should improvements be made by the tenant with the landlord's consent, the latter must indemnify the tenant in an amount equal to the lesser of the total amount expended and the actual value of the improvements at the time of the yielding up of the leased premises to the landlord at the end of the lease.

Pursuant to Article 1593 of the Civil Code, at the termination of the lease, the tenant may remove the additions made to the leased premises, provided that removal can be effected without causing damage to the property and unless the landlord prefers to retain them; in this latter case, the landlord must indemnify the tenant in an amount equal to the lesser of the total expenditure and the value of the additions at the time of the yielding up.

The parties may amend the provisions of Articles 1584, 1592 and 1593 of the Civil Code, providing that no indemnity or compensation is due to the tenant in the case of, respectively, repairs, improvements or additions to the leased premises.

vii Lease agreements for activities involving direct customer contact

The following provisions apply to commercial lease agreements for activities involving direct contact with customers or consumers, such as retail units, supermarkets and commercial galleries.

Goodwill indemnity

Article 34 of the Lease Act provides that, upon termination of the lease agreement, the landlord must compensate the tenant for the loss of the relevant commercial goodwill in connection with the leased premises. Such compensation shall be equal to 18 months' rent, calculated *pro rata* on the basis of the last rent paid. No goodwill indemnity shall be paid, however, if the termination of the lease agreement is due to the tenant's default (e.g., tenant's breach of contract, its decision not to renew it at the expiration date, or its withdrawal).

The amount of the goodwill indemnity is doubled if a business activity of the same kind is established in the premises within one year from the relevant termination date.

Any clause of a lease agreement excluding the tenant's right to the goodwill indemnity is null and void. The tenant, however, is free to waive the indemnity at the expiration of the lease.

Right of pre-emption

Pre-emption right in the event of sale of the leased premises

Pursuant to Article 38 of the Lease Act, the tenant has a pre-emption right in the event of sale of the let premises.

If the landlord intends to sell the let premises, it must give the tenant prior written notice setting out the price and the terms of the sale, and invite the tenant to exercise its pre-emption right. The tenant may exercise such right within 60 days of receipt of the notice, offering the same terms as set out in the notice delivered by the landlord.

Should the landlord fail to notify the tenant of its intention to sell the let premises, the tenant, within six months from the registration of the deed of transfer executed by the landlord and a third-party buyer of the let premises, will be entitled to apply to the court and seek an order that declares such sale (and any subsequent sale of the let premises by the buyer) null and void.

According to the Italian Supreme Court, the limitation of the right of the landlord to dispose of the real estate unit provided for by Article 38 of the Lease Act applies only where the let premises to be sold exactly match the leased property.

In this respect, the Supreme Court has consistently stated that the tenant's pre-emption right is excluded in the case of sale as a whole of the building of which the let property represents a portion, the whole building being different (from both an economic and legal standpoint) from the relevant let portions; and sale as a whole of different real estate properties (one or more of which is subject to one or more lease agreements) that are functionally and structurally connected to each other so as to be different from the single portions thereof.

Pre-emption right on new leases

Pursuant to Article 40 of the Lease Act, unless the termination of the lease agreement is due to the tenant's default (e.g., tenant's breach of contract, its decision not to renew it at the expiration date or its withdrawal), the tenant has a pre-emption right at the expiry of the six-year period (renewed for a supplementary six-year period) in the event the landlord intends to enter into a new lease with third parties. In particular, the landlord must give the tenant prior written notice (at least 60 days before the expiration of the lease agreement) setting out the terms and conditions of the offer.

The tenant may exercise such right within 30 days from receipt of the notice, offering the same terms as set out in the notice delivered by the landlord. If the tenant has not exercised its pre-emption right upon termination of the lease, and a new lease agreement is entered into by the landlord, and subsequently terminated within one year of the inception, the original tenant may still exercise its pre-emption right.

viii Land Registry registration and related taxes

According to Article 2643, of the Civil Code, a lease agreement relating to immoveable assets with a term exceeding nine years must be registered with the Land Registry. Registration is necessary to ensure that the lease agreements and the tenant's rights are valid and enforceable against any subsequent purchaser of the let properties. To this end, the lease agreement must be written in Italian, legalised by a notary public and a flat registration tax must be paid.

VII DEVELOPMENTS IN PRACTICE

The main developments that may be expected for 2014–2015 include:

a the consolidation of the role of foreign investors as a driving force on the Italian real estate market;

b a possible realignment in property prices driven by the significant disposals programmes that will have to be put in place by, inter alia, Italian REIFs approaching their term, and by financing banks repossessing defaulting assets; and

c the continuing importance of real estate debt restructuring transactions as a component of the market in 2012–2013.

2013 also saw some significant legal developments affecting the Italian real estate market.

i Possible liberalisation of the Italian real estate market and other legislation aimed at attracting foreign investors

In 2013, the government indicated its intention to implement significant reforms of the Italian real estate market legislation, including:

a a liberalisation of the Italian lease law, with the possibility for the parties to freely negotiate contractual terms;

b a reform to the tax regime applicable to SIIQs, aligning their tax treatment to the favourable tax treatment applicable to Italian REIFs, thus making it tax-neutral to opt for either other instrument; and

c a reform of the legislation governing credit funds, aimed at increasing the role of such instruments in the credit market (such measures were enacted in December 2013).

ii Sale of government real estate

The government has signalled that it intends to take a more active role in the management of its large real estate holdings, and has approved framework legislation opening up the possibility of disposal or valorisation of part of its real estate portfolio. Possible initiatives include the setting up of an asset management company that will catalyse public and private resources for the valorisation of state-owned properties to be redeveloped, and a disposal process aimed at reducing Italian public debt.

VIII OUTLOOK AND CONCLUSIONS

2013 saw a significant increase in real estate activity mainly driven by a return of foreign institutional investors in the Italian real estate market. With the easing of the eurozone crisis and signs of recovery in Europe, the Italian real estate market is seen as offering potentially attractive opportunities. The banking real estate debt market is still very tight and expensive, with investors searching for opportunities in the alternative debt markets (bonds, credit funds).

Chapter 18

JAPAN

Norio Maeda, Tomohiro Kandori, Naoko Katakami and Kozo Kuromatsu[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

The basic ways in which real estate can be held are either holding ownership title to real estate directly or holding a beneficial interest in a trust that holds title to real estate in connection with large-scale commercial investments.

Land and buildings are considered separate and independent real estate. Therefore, one person can hold title to land while another person can hold the title to a building on the land. When different persons own a building and the parcel of land upon which the building is located, the two owners will typically enter into a contract such as a land-lease agreement where the building owner is permitted to use the land.

Joint title to real estate, which is governed by the rules under the Civil Code, is one form of title that can be held by multiple persons. Condominium title to a condominium that is part of a building, which is governed by both the rules under the Condominium Law and by the Civil Code, is another form of title that can be held by a single person separately from other condominium owners of the building.

Trust beneficial interests in real estate are typically issued when a real estate owner places the real estate in a trust. The trustee holds title to the real estate placed in the trust. The owner, on the other hand, holds a trust beneficial interest that represents a contractual relationship with the trustee under a trust agreement. Under this, the beneficiary may instruct the trustee to administer and manage the real estate in the trust and to distribute profits earned from the real estate (after deducting costs and expenses for administration and management of the real estate). Trust beneficial interests are used for various reasons including delegating administrative duties from the beneficiary to

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the trustee, and deferring taxes related to real estate transfers by transferring the trust beneficial interests instead.

ii System of registration

Ownership title and other property rights with respect to real estate are typically registered in the real estate registry maintained by local registration offices. Trustees are typically the registered owners of real estate that is placed in trust. The general rule is that transactions including the sale and purchase of real estate and creation of a mortgage on real estate take effect upon execution of agreements between the parties, and that no formalities are required; however, the holder of ownership title or other property rights with respect to real estate must have its interest registered in the appropriate real estate registry to assert its rights against a third party. This means that generally, to perfect a right over real property, there must be a valid agreement between the parties and the right must be registered in the name of the holder. The registration is governed by the Real Estate Registration Law.

While registration of a real property right in the name of a certain person does not necessarily mean that the person actually holds the registered right, registration is usually considered strong evidence. Neither the local registration office nor the government guarantees the accuracy of the real estate registry. A registration in the real estate registry only reflects and records the transactional activities that private persons described in their applications for registration.

iii Choice of law

In the context of a cross-border transaction, choice of law rules are provided in the Act on General Rules for Application of Laws. Under the Act, if the subject matter is a property right or other right that can be registered in the real estate registry, the law of the jurisdiction in which the real estate is located shall be the governing law; however, under the Act, any law chosen by the parties can govern a contract. Despite the Act permitting the parties to choose the governing law of the contract, parties usually choose Japanese law as the governing law of a sale and purchase agreement with respect to real estate, because of the rule that Japanese law governs property rights in Japan.

II OVERVIEW OF REAL ESTATE ACTIVITY

Since the early 1990s, various innovative real estate investment structures have been developed in Japan.

The GK–TK structure and the specified-purpose company (TMK) structure (discussed in detail in Section IV, *infra*) are frequently used for real estate investment. Japanese real estate investment trusts (J-REITs) (discussed in Sections IV and VII, *infra*) have made it possible for investors with smaller amounts of capital to invest in real estate through the purchase of listed J-REIT securities. The accumulated capital of the listed J-REITs has made them major players in the Japanese real estate investment market. The flow of capital through listed J-REITs into the real estate investment market has contributed to the growth of the real estate industry.

The increase in flexibility of such investment structures has resulted in a greater influx of domestic and foreign capital into real estate. The response to demand from an increasing number of participants has made the real estate investment market more sophisticated and attractive, so that a number of investors consider the Japanese real estate market an important strategic focus in their global investment strategy.

After recent global economic turmoil affected – and slowed down – activities in the Japanese real estate investment market (including activities by lenders), it also prompted further regulatory developments. The government has brought in various measures to relax regulations and enhance market activities (recent key developments are highlighted in Section VII, *infra*), while the Japanese economy is showing signs of recovery.

III FOREIGN INVESTMENT

There are no direct restrictions on acquisitions of commercial or residential real estate in Japan by foreign investors, either directly or through a vehicle. Similarly, establishment of a corporation by foreign investors to invest in commercial or residential real estate is not restricted. In theory, under the provisions of the Alien Land Law, a cabinet order may limit the rights of foreign investors related to land in Japan on the grounds of reciprocity or national security. At the time of writing, however, there has been no such limitation, since no such cabinet order has been issued.

Under the Agricultural Land Act, an authorisation by the relevant authority is required to acquire certain agricultural land. This authorisation can only be granted if the purchaser is qualified as a farmer or an agricultural production corporation. It would not be easy for foreign investors to be granted such authorisation.

After a foreign investor's acquisition of shares or equity of a corporation, or acquisition of real estate or a right related to real estate, a post-transaction report to the government authority may be required pursuant to the Foreign Exchange and Foreign Trade Law (the FEFTL). A post-transaction report of payment or receipt of payment may be required in the case of cross-border payments or payments between a foreign investor and a Japanese resident in accordance with the FEFTL.

IV STRUCTURING THE INVESTMENT

When choosing an investment structure, the legal accounting and tax implications must be considered, because each can be a driving factor for the choice. The most popular structures and investment vehicles used for real estate investments in Japan are the GK–TK structure, the TMK structure and the J-REIT.

i GK–TK structure

A limited liability company (GK) is one of the types of corporate entities under the Companies Act. In some respects, it is similar to an LLC in the United States; however, it is not itself a pass-through entity for tax purposes. When a GK is used as an asset investment vehicle, typically an investor leverages its investment by third-party loans and makes its own investment in the GK through a contractual anonymous partnership

(TK) arrangement. The TK arrangement is a bilateral (not multilateral) contractual partnership relationship created for the investment purposes by the TK interest holder, called the TK investor. The other party to the contract is called the TK operator. Under the GK–TK structure, the TK operator is the GK. A TK arrangement qualifies for favourable tax treatment if the TK investor is a passive investor with minimal control over the management of the GK and the contributed funds under the arrangement. If the TK arrangement qualifies, the GK is permitted to deduct distributions to the TK investor from its taxable profits in addition to deducting debt payments. This tax-efficient combination of a GK and a TK arrangement is called a GK–TK structure.

Typically, a GK–TK structure has been used to make investments in trust beneficial interests in real estate, and loans backed by real estate. If a GK holds real estate directly, by raising funds from TK investors, it will generally be subject to a licensing requirement under the Real Estate Specified Joint Enterprise Act (the REJEA). Therefore, the GK–TK structure has usually been structured to invest in trust beneficial interests in real estate, not in real estate itself. A newly introduced exemption from the licensing requirement under the REJEA (discussed in Section VII, *infra*) will allow the GK-TK structure to invest into real estate itself, if certain requirements are satisfied.

A GK–TK structure that is used to invest in a trust beneficial interest in real estate will subject the GK to the strict registration requirement under the Financial Instruments and Exchange Law (the FIEL), unless an exception applies. One of the exceptions available under the FIEL is the QII exemption, which essentially requires that:

a there is at least one qualified institutional investor (QII) under the FIEL among the TK investors;

b the number of non-QII TK investors (if any) is 49 or less;

c none of the TK investors is a disqualified investor as detailed in the FIEL; and

d the GK, as the operator of the TK arrangement, files with the government authority a simple notification regarding the QII exemption.

ii TMK structure

A TMK incorporated under the Asset Liquidation Law (the ALL) is another type of corporate entity often used as a real estate investment vehicle. This entity may only be used to liquidate or securitise certain assets. This investment platform is used to make investments in real estate, trust beneficial interests in real estate, and loans and TMK bonds that are backed by real estate. A TMK is typically funded by issuing TMK bonds and preferred shares that meet certain tax qualifications required for preferential tax treatment of the TMK. If a TMK, its bonds and its preferred shares are properly structured, and the TMK meets certain other requirements under the Tax Code, it is permitted to deduct distributions to the preferred shareholders from its taxable profits in addition to deducting debt payments.

One of the requirements for the preferential tax treatment is that its TMK bonds be purchased by an institutional investor or other similar person or entity (a Tax II or equivalent investor) as defined in the Tax Code. Certain QIIs under the FIEL and certain other QIIs meeting certain additional requirements fall under the definition of a Tax II or equivalent investor. One of the important steps in setting up a TMK structure is to find a TMK bondholder that is a QII and is a Tax II or equivalent investor.

When using a TMK structure, it is also important for the TMK to comply with strict regulations under the ALL. These regulations include a requirement to file an asset liquidation plan with the government authority. The asset liquidation plan of a TMK outlines how its assets are to be liquidated or securitised. A TMK structure requires close attention being paid to the regulations regarding the asset liquidation plan.

iii J-REITs

A J-REIT is a type of investment fund formed under the Law concerning Investment Trusts and Investment Companies (the ITL). A J-REIT established to invest in and manage real estate assets uses investors' funds to purchase real estate assets, in return for which investors receive investment units. The investment units of a J-REIT can be listed and traded on the stock exchange. If a J-REIT's investment units are listed, the J-REIT must comply with the rules of the stock exchange in addition to the ITL. Under the ITL, a J-REIT must retain an asset management company (a registered financial instruments operator under the FIEL) to manage its investment. In practice, all investment decisions for a J-REIT are designed to be made by its asset management company.

Unlike an ordinary corporation, which is subject to corporation tax on its profits, a J-REIT is exempt from taxation if certain requirements are satisfied, including:

a the J-REIT is not engaged in any business other than that permitted for J-REITs;
b the J-REIT would not be classified as a family corporation as defined in the Tax Code at the end of its fiscal period;
c the J-REIT distributes more than 90 per cent of its profits as dividends to the holders of its investment units for each fiscal period; and
d more than 50 per cent of the investment units on an aggregate issued amount basis have been offered in Japan.

The basic concept underlying the J-REIT legislation is that unlike a GK–TK structure or a TMK structure, a J-REIT's investments are not limited to certain assets specified at the time of its start-up. By raising long-term funds through a combination of debt and equity financing, a J-REIT can continue to accumulate and replace its investment portfolio for a longer term. At the same time, however, it would distribute most of its profits (more than 90 per cent of its profits) to the holders of its investment units for each fiscal period as described above and therefore may not have sufficient internal reserve funds. When structuring a J-REIT, it is important to mitigate the potential risks of not having sufficient funds to deleverage its debt during an economic downturn. Since a J-REIT would practically be restricted regarding the amount of reserves it may retain, it should adopt another financial strategy to mitigate the potential risks, such as keeping its debt-to-asset ratio at a conservative level.

V REAL ESTATE OWNERSHIP

i Planning

City Planning Law

The City Planning Law is the primary national law that governs real estate development and zoning.

Under the City Planning Law, land development is strictly controlled in urbanisation control areas. Developers are required to obtain approval from local government authorities for developments in areas designated for urbanisation. Approval is given if the proposed development meets certain requirements under the City Planning Law.

There are various local laws established under the framework of the City Planning Law. Local government authorities are granted the power to control land use in accordance with the City Planning Law and the local laws.

Building Standards Law

The Building Standards Law provides regulations with respect to construction of a building, including regulations with respect to its use and the ratio of its total floor area to its site area.

Under the Building Standards Law, the appropriate local government authority must approve construction work for a building before the work commences; furthermore, a completion inspection of the building by the appropriate local government authority is required upon completion of work.

ii Environment

Under the Soil Contamination Countermeasures Law, if a manufacturing factory that uses certain hazardous materials ceases its operations, the owner, manager or occupant of the land (the landowner) must examine the land and test for contaminants. In addition, in the case of the development of a large area of land (at least 3,000 square metres), the developer must notify the appropriate local government authority at least 30 days before any change is made to the land. After receiving such notice, if the authority determines that the land may be contaminated in the manner designated by the Soil Contamination Countermeasures Law, it may order the landowner to investigate. The local government authority also may order a landowner to examine land and conduct testing for contaminants if it determines that the land may harm the health of inhabitants in the neighbourhood through underground water or otherwise in the manner designated by the Soil Contamination Countermeasures Law. If the result of an examination of the land reveals that the relevant regulations have not been met, local government authorities will designate the land as a contaminated area and require appropriate measures, including cleaning up the land, to prevent public health from being impaired.

iii Tax

Stamp taxes, registration and licence taxes and real estate acquisition taxes apply when ownership title of real estate is transferred.

General

Stamp taxes are paid by affixing a revenue stamp on a taxable document. An agreement to transfer ownership title to real estate requires a stamp tax of progressive amounts ranging from ¥200 to ¥600,000 based on the purchase price provided in the agreement.

Registration and licence taxes are imposed when registering certain matters with respect to real estate with the appropriate local registry. The tax rate to register a transfer of ownership title to real estate is generally 2 per cent. A rate of 1.5 per cent will apply to registration regarding a transfer of land occurring between 1 April 2013 and 31 March 2015. The transfer of ownership title to certain qualified residential buildings that are acquired by an individual to reside in will be 0.3 per cent or 0.1 per cent.

Real estate acquisition taxes are imposed on a purchaser of real estate at a rate of 3 per cent (for land and for residential buildings) or 4 per cent (for non-residential buildings).

Beneficial treatment

Transfer to a TMK

If a TMK acquires real estate and meets certain requirements, it may qualify for the following tax benefits:

a the registration and licence taxes to register the acquisition until 31 March 2015 will be reduced to 1.3 per cent; and

b three-fifths of the price for the acquisition will be excluded when calculating the related real estate acquisition taxes until 31 March 2015.

Transfer of trust beneficial interest

Using a trust structure where the trustee holds ownership title to real estate provides certain tax benefits. Stamp taxes for real estate trust agreements and for sale and purchase agreements for a trust beneficial interest in real estate is ¥200, which is substantially less than stamp taxes for a sale and purchase agreement of real estate itself. While registration and licence taxes and real estate acquisition taxes will be imposed on a purchaser of real estate, the following reduced registration and licence taxes will be imposed on real estate being placed in trust and on a trust beneficial interest in real estate being transferred from the initial holder to the purchaser:

a on placing the real estate in trust: 0.3 per cent or 0.4 per cent (for land) or 0.4 per cent (for buildings); and

b on transfer of the trust beneficial interest: ¥1,000 for each building and piece of land.

Real estate acquisition taxes are not imposed on real estate when it is placed in trust or on transfer of the trust beneficial interest.

When the holder of a trust beneficial interest in real estate (other than the initial holder), however, terminates the trust agreement and receives delivery of the real estate from the trustee, registration and licence taxes at a rate of 2 per cent will be imposed upon registering the transfer of real estate. Upon such transfer, real estate acquisition taxes will also be imposed on the beneficiary at a rate of 3 per cent (for land and for residential buildings) or 4 per cent (for non-residential buildings).

By applying the tax benefits of a trust structure as described above, a substantial amount of taxes related to a real estate acquisition can be deferred until the trust agreement is terminated and the real estate is delivered to the beneficiary.

Transfer of real estate to a GK-TK structure newly introduced under the amendment to the REJEA

If a GK-TK structure newly introduced under the amendment to the REJEA (discussed in Section VII, *infra*) acquires an old building that needs to be rebuilt or renovated (defined as a building older than 10 years or a building seriously damaged by a disaster); land planned to be used for a newly built building replacing an old building or built on unimproved land; or land used for a building planned to be renovated, by meeting certain other requirements, it may qualify for the following tax benefits:

a the registration and licence taxes to register the acquisition until 31 March 2015 will be reduced to 1.3 per cent; and

b half of the price of the acquisition will be excluded when calculating the related real estate acquisition taxes until 31 March 2015.

iv Finance and security

Mortgages on real estate are the most frequently used form of security interest in real estate.

In general, once the mortgage is registered, it is granted priority over unsecured creditors; however, even a registered mortgage is subordinate to tax claims against the mortgagor that became due prior to the registration of the mortgage. The registered mortgage will also be subordinate to any previously registered mortgages or other previously registered security interests on the same real estate.

Another form of security interest in real estate that is frequently used is a pledge over a trust beneficial interest in real estate. If real estate is held in the form of a trust beneficial interest in real estate, the lender would create a pledge over the trust beneficial interest and not a mortgage on the real estate itself. Perfection of the pledge is made by obtaining the consent of the trustee with a date certified by a notary public.

TMK bondholders are granted security interest by operation of law, which is a statutory general security interest on all the current and future assets of the TMK granted in their favour under the ALL. The statutory general security interest will also secure (by operation of law under the ALL) all the TMK bonds subsequently issued. In many cases, therefore, holders of TMK bonds do not create a mortgage or pledge on the real estate or trust beneficial interest in real estate held by the TMK. This is mainly because the mortgage and pledge securing the bonds need to be held by a trustee in accordance with the Secured Bond Trust Law, and additional costs to establish such a trust arrangement are not considered economically justified in many cases.

VI LEASES OF BUSINESS PREMISES

The Land Lease and Building Lease Law (the LLBLL) and the Civil Code regulate real estate leases. The general rule is that the LLBLL is applicable to land leases that are made for the purpose of the lessee owning a building on the land, and to building leases. The LLBLL takes precedence over the Civil Code when their provisions overlap.

i Types of lease

The LLBLL provides for various types of lease, including the following:

Land lease for the purpose of a lessee owning a building on the land

Ordinary land lease

Under the LLBLL, a land lease made for the purpose of the lessee owning a building on the land (other than a fixed-term land lease as discussed below) has a 30-year term, unless the parties agree to a longer term. Such land leases are automatically renewed for a term of 20 years for the first renewal and 10 years for subsequent renewals unless otherwise agreed by the parties. The lessor cannot object to such renewal without a justifiable reason. Generally, a justifiable reason is not easy to establish, and the lessor's refusal to renew the lease is strictly restricted.

Fixed-term land lease

A fixed-term land lease made for the purpose of the lessee owning a building on the land is not renewable under the LLBLL; however, the parties are not prohibited from entering into a new lease agreement at the expiry of the lease. Fixed-term land leases were introduced because concerns of landowners about the strict restrictions on the ability of the owners of land to refuse to renew a land lease were considered to inhibit effective use of real estate. There are three types of fixed-term land leases:

a a general fixed-term land lease available for either residential purposes or business purposes (the fixed term is 50 years or longer);

b a land lease with a special agreement by which the lessee assigns the building on the land to the lessor (the lease agreement can provide for the lessor's right to obtain the building on the land from the lessee at a reasonable price in order to terminate the lease after 30 or more years following the commencement of the lease); and

c a fixed-term land lease for business purposes (the fixed term is 10 years or more but must be shorter than 50 years).

Building leases

Ordinary building lease

A building lease usually has an agreed term. Under the LLBLL, a building lease with an agreed term (other than a fixed-term building lease as discussed below) is automatically renewed and the lessor cannot object to the renewal of the building lease without a justifiable reason. Generally, a justifiable reason is not easy to establish and the lessor's refusal to renew the lease is strictly restricted.

Fixed-term building lease

A fixed-term building lease is not renewed under the LLBLL; however, the parties are not prohibited from entering into a new lease agreement at the expiration of the lease term. The parties can agree on the fixed term without restriction on its duration.

ii Typical provisions

There are typical provisions for leases of business premises in Japan regarding increase or reduction of rent, termination, and assignment of lease or sublease.

Rent increase or reduction

Under the LLBLL, if the amount of rent payable becomes inappropriate (e.g., if it differs significantly from the market rent), the lessor or the lessee may request that it be increased or reduced. This applies both to land leases made for the purpose of the lessee owning a building on the land and to building leases. The parties to the lease agreement, however, can eliminate the right to request an increase in rent by agreeing not to increase the amount of rent for a certain period. The right to request a reduction cannot be eliminated from a lease that is not a fixed-term building lease.

Termination

Under the Civil Code, if one party breaches an agreement, the other party can terminate it; however, under the Supreme Court precedents, a lessor cannot terminate a real estate lease agreement if the lessee can establish the existence of a special circumstance where a relationship of mutual trust remains between the lessor and the lessee even after the breach. Failure to pay rent for several months would usually entitle the lessor to terminate the lease, because such non-payment would usually be regarded as destroying the relationship of mutual trust.

Assignment of lease or sublease

Lease agreements usually prohibit the lessee from assigning the lease or subletting without the consent of the lessor.

VII DEVELOPMENTS IN PRACTICE

i Amendment to the REJEA

Background

Under the REJEA, a TK operator that was formed to invest in real estate directly, not a trust beneficial interest in real estate, is subject to a licensing requirement. To obtain the licence, a TK operator must satisfy certain requirements, including standards of financial capability and human resources. Such requirements have made it practically impossible for a TK operator vehicle to obtain that licence. To work around the licensing requirement, investment platforms involving TK arrangements have mostly invested into trust beneficial interests in real estate.

However, converting real estate into a trust beneficial interest involves relatively strict scrutiny by the trustee of the subject real estate. Just as there are investors who would like to have their TMKs invest into real estate directly, rather than a trust beneficial interest in real estate, there have also been investors who would like to have their GK-TK structures invest into real estate directly, if possible.

To respond to this demand from investors, the REJEA was amended in June 2013 (such amendment came into effect on 20 December 2013) to enable a TK arrangement to invest into real estate without requiring the TK operator vehicle itself to obtain a licence.

New investment structure

The amendment to the REJEA allows a GK-TK structure to invest into real estate directly, without the GK as the TK operator vehicle needing to obtain a licence, if certain requirements are met.

The first requirement is for the GK as the TK operator to delegate (1) the management of transactions related to the subject real estate and (2) the solicitation of investments into the TK operator by the TK investor (or investors) to a real estate specified joint enterprise business operator (REJEB operator) that is licensed under the REJEA.

The requirements for the licence of a REJEB operator are the same as those under the REJEB prior to the amendment. Under this new requirement, the amended REJEA allows a licensed REJEB operator to be involved in a TK arrangement investing into real estate, not as a TK operator itself, but as a manager for the TK operator vehicle, as long as the delegation of the management covers (1) and (2) as described above. The second requirement is that only investors falling into one of the categories of 'special investors', which include a licensed REJEB operator and a QII (as defined under the FIEL), make TK investments in the TK operator.

It is hoped that the new GK-TK structure will enhance investment into real estate without the need to involve a trustee at the underlying real estate level.

To enhance the use of the new GK-TK structure, a GK-TK structure satisfying the above-mentioned requirements will benefit from reduced registration and licence tax, and real estate acquisition tax, when such GK-TK structure acquires a building that is over a certain age, or acquires a building for the purpose of reconstruction. For more details on the reduction of these taxes, see Section V, *supra*.

ii Amendment to the ITL and the FIEL in connection with J-REITs

Background

Because more than a decade has passed since the introduction of J-REITs under the ITL, various issues regarding the legal framework of J-REITs have been discussed. The issues include:

- *a* improving the diversity available to J-REITs regarding their capital strategy;
- *b* the application of insider trading rules to achieve greater transparency in the management of J-REITs and in the trading of J-REIT investment units with the goal of securing more investor trust;
- *c* achieving stronger investor protection against potential conflicts of interest between a J-REIT and the controlling shareholder of the J-REIT's asset management company, where practically the shareholder can influence the management of the J-REIT;
- *d* stronger investor protection in the event that the issue price of a J-REIT's investment units does not reflect the fair market value; and
- *e* expansion of a J-REIT's scope of investment to include foreign real estate.

To address the issues that have been discussed, the ITL and the FIEL were amended in June 2013 (to become effective in June 2014).

Diversification of the methods available to J-REITs regarding their capital strategy

As described in Section IV, *supra*, to enjoy the tax benefit available to a J-REIT, the J-REIT must distribute more than 90 per cent of its profit as dividends to the holders of its investment units for each of its fiscal periods. This requirement makes it difficult for J-REITs to maintain internal reserves. In addition, the term of debt financing available to J-REITs is normally shorter than debt financing available to normal operating companies. As a result, there is an inherent weakness in the financial capability of J-REITs. Diversification of the methods available to J-REITs regarding capital strategy has been discussed to address such weakness.

The methods newly made available to J-REITs regarding their capital strategy under the amendment to the ITL include a rights issue and a right to purchase their own investment units. In the case of normal operating companies a rights issue has, together with a public offering of shares and third-party allocation of newly issued shares, been one method to increase the share capital. The amendment to the ITL will make the rights issue available to J-REITs. In the rights issue, the current holders of a J-REIT's investment units are granted the rights to purchase the newly issued investment units in the J-REIT. The holders of its investment units may instead sell the rights to third parties.

The right to purchase its own investment units will enable a J-REIT to reduce the effect of the movement of the price of its investment units in the financial market, especially if the investment units are traded in a stock exchange.

Insider trading rules

After the amendment to the ITL and the FIEL, transactions involving investment units issued by listed J-REITs will be subject to the insider trading rules under the FIEL. Transactions regulated under the FIEL's insider trading rules include the sale and purchase (and the like) of certain designated securities regarding listed companies made by company insiders who have come to know certain material facts regarding the business or other matters of the listed companies, unless such facts are already publicised.

Company insiders under the amended FIEL include:

a a J-REIT, its asset management company, and the officers of a J-REIT and its certain designated affiliates;

b the holders of a J-REIT's investment units, and the shareholders who have the right to request inspection of the books of a J-REIT's asset management company and a J-REIT's certain designated affiliates; and

c a person who has entered into an agreement with a J-REIT, its asset management company or a J-REIT's certain designated affiliates.

The amended FIEL will consider not only the material facts regarding a J-REIT, but also the material facts regarding its asset management company, as the material facts subject to the insider trading rules. While the insider trading rules will apply to listed J-REITs, private J-REITs will not be subject to the insider trading rules.

Investor protection from potential conflicts of interest between a J-REIT and a controlling shareholder of a J-REIT's asset management company

The asset management company retained by a J-REIT has broad discretion regarding the management of the assets of the J-REIT. As a result, a controlling shareholder of the asset management company can exercise a significant influence on the management of the assets of the J-REIT. Such issue is more relevant if the J-REIT is to purchase real estate from an affiliate of the controlling shareholder of the J-REIT's asset management company. There may be an issue with respect to, for example, the selection of the investment opportunity, the purchase price of the real estate and the timing of the purchase. The amendment to the ITL requires certain designated transactions, such as transactions between the J-REIT and an affiliate of its asset management company, to be approved in advance by the board of officers of the J-REIT.

Injunction by holders of investment units of a J-REIT against new issuance of investment units

Under the ITL, prior to the amendment, holders of a J-REIT's investment units did not have a right to petition for an injunction against the J-REIT's new issuance of investment units, even when the issue price did not reflect the fair market value of the investment units. However, the amendment will give investment unit holders a right to petition for an injunction. The injunction will be granted if the issuance of the investment units is made in violation of the constitution of the J-REIT or under significantly unfair conditions. With the right to petition for an injunction, the holders of investment units will be given stronger protection economically, by preventing dilution of the value of the investment units of the J-REIT in advance.

Expanded capability of J-REITs to invest in foreign real estate

Under the ITL, even prior to the amendment, J-REITs were not prohibited from investing in foreign real estate. However, there has been an obstacle in practice, because before the amendment, J-REITs were prohibited from owning a majority of shares in a company. Due to this prohibition, J-REITs were not able to acquire foreign real estate through any investment vehicle.

The amendment to the ITL includes an exception to such prohibition. Under the exception, J-REITs will be allowed to acquire a majority of shares in an investment vehicle established mainly for the purpose of investing in foreign real estate.

VIII OUTLOOK AND CONCLUSIONS

The amount of real estate assets acquired by J-REITs in 2013 is the highest ever recorded. Compared with 2013, the amount of acquired real estate assets was around three times the amount acquired in 2012. The improvement of the legal framework for J-REITs through amendments to the ITL and the FIEL, such as the diversification of the methods available to J-REITs with regard to their capital strategy (see Section VII, *supra*), will provide a more stable basis for the growth of J-REITs' real estate investments. The amendment to the REJEA (see Section VII, *supra*) will also provide more flexibility to structure real estate investment by enabling a GK-TK structure (that is not licensed but satisfies certain requirements) to invest in real estate without the need to hold it using a trust structure (i.e., a trust beneficial interest in real estate), as has typically been used. While these amendments are certainly a great stride forward in light of the growth of the real estate market, it is hoped that the government will keep improving the legal framework for real estate investment to bring about further long-term growth in this market.

Chapter 19

JERSEY

Christopher Philpott and Will Whitehead[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

Jersey is the largest of the Channel Islands. It is a self-governing British Crown dependency with its own financial and legal systems and its own courts of law. Jersey property law is derived from a mixture of local legislation and customary (common) law, which has its roots in the ancient customary law of Normandy.

i Ownership of real estate

Ownership of real estate in Jersey (immoveable property) can broadly be separated into the following rights of tenure:

a Ownership *a fin d'heritage* (freehold): this is the most comprehensive and preferred form of ownership. While not directly equivalent, this is often compared to the English law concept of fee simple absolute. Ownership *a fin d'heritage*, as the term suggests, gives rights in perpetuity.

b Leasehold: there are two types of lease in Jersey. Shorter-term tenancies with a term of nine years or less are documented by means of private agreement between the parties and are known as paper leases. There are no registration formalities. Leases with a term of more than nine years are referred to as contract leases and must be registered before the Royal Court of Jersey to be legally valid and binding.

c Flying freehold: flying freehold properties are established in accordance with the Loi (1991) sur la copropriété des immeubles bâtis.[2] This type of ownership is typically used for apartment blocks and mixed-use properties. An owner of a

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2 Jersey statutes, particularly those relating to immoveable property, were traditionally drafted in the French language (being the original official language of the Royal Court and the States of Jersey). Most modern legislation is now drafted in English, save where original French

flying freehold lot (i.e., a specific part of a building) has exclusive ownership of the lot and a shared interest in the common parts. The extent of the lot and the rights and obligations of the various owners are specifically defined within a co-ownership declaration that must be registered before the Royal Court of Jersey to be legally valid and binding.

d Share transfer: share transfer ownership structures are used as a method of dividing ownership of a property (usually apartment blocks) into separate units. The freehold of the property is acquired or owned by a Jersey company, and individual owners hold shares within that company rather than any direct interest in the underlying freehold. The company's articles of association confer on the holder of certain shares the exclusive right to use and occupy a specified unit (or units). Rights relating to common areas and other shared or communal services are defined within the company's articles of association.

ii System of registration

Jersey does not have a system of registered title, and there is no state guarantee of title available. All hereditary contracts relating to land in the island must be passed before the Royal Court of Jersey, and thereafter such contracts are registered in the Jersey Public Registry and are available for public inspection.

To confirm good title to a property, it is the responsibility of the purchaser's lawyer to undertake researches within the Jersey Public Registry to track the route of title and to examine the registered contracts for restrictions and benefits (servitudes) affecting the land in question.

Until November 2006, all hereditary contracts (other than contract leases) were written and registered in the French language, and consequently researching title to Jersey real estate requires specialist knowledge. While hereditary contracts are now written and registered in English, practitioners are required to understand and interpret original French clauses as created in earlier contracts in order to establish good and marketable title to a property.

As all hereditary contracts must be passed before the Royal Court of Jersey, there is no requirement for them to be signed or executed by the parties. Each party (either personally or by attorney) must appear before the Royal Court to register the hereditary contract. The Royal Court of Jersey sits to register property contracts on Friday afternoons.

Share transfer properties (see above) are transacted differently, with the parties entering into a share purchase agreement for the acquisition of the shares. Such agreements are private, and do not require registration in order to be perfected. Such transactions can be exchanged and completed on any day of the week by agreement between the parties (and not only on Friday, as with transactions involving freehold or flying freehold properties).

legislation is being amended, or occasionally where legislation relates to the Loi (1880) sur la propriété foncière – which law provides the statutory foundation of Jersey property law.

iii Choice of law

Jersey law will apply to most transactions involving Jersey real estate. Contracts may include express provisions relating to the choice of governing law (which in general the Jersey courts will uphold) but formalities for concluding transactions, including registration of contracts in the Jersey Public Registry and the taking of security over real estate, will be governed by Jersey law and practice.

II OVERVIEW OF REAL ESTATE ACTIVITY

Jersey has not escaped the difficult market conditions experienced worldwide during recent years. The island's economy is heavily reliant on its international financial services industry, which has endured significant challenges, both on a local and global scale. Activity levels in both the commercial and residential property sectors have been subdued for the past three years, but confidence returned during Q3 and Q4 of 2013, which is reflected in the number of property transactions being undertaken. Works are starting on many commercial developments that were put on hold over recent years, which is an indication of a returning confidence and the availability of finance for such projects.

There appears to be significant political will to simplify and speed up the local planning process, which it is hoped will continue to increase the number of new developments and projects coming online.

Jersey's commercial property market continues to be attractive not only to local investors but also to foreign investors looking for commercial office premises with longstanding and reputable financial service providers as tenants, and where good returns have continued despite difficult market conditions. Jersey commercial property is seen as adding an element of diversity to most investment portfolios.

The residential sector experienced a general reduction in property values over the past three years, but these have stabilised during 2013. Continued low interest rates have provided some comfort to homeowners on variable mortgages. The renewed availability of finance from local lenders continues to have a positive effect on activity levels in the residential sector. The States of Jersey have recently approved the continuation of a stamp duty concession available to first-time buyers buying residential properties up to £450,000. Other government initiatives aimed at supporting the residential sector include the States of Jersey Starter Home Deposit Loan Scheme, which aims to help first-time buyers who may be able to afford loan repayments but do not have sufficient capital to put forward a deposit.

III FOREIGN INVESTMENT

Land is a scarce resource in Jersey. Due to the high levels of demand, the real estate market (particularly the residential sector) is regulated by the States of Jersey. Certain transactions involving the sale, acquisition or transfer of Jersey real estate (including the registration or assignment of contract leases) may require prior notification to, or consent of, the States of Jersey Housing Minister.

The residential real estate market in Jersey is highly regulated to preserve the housing stock for locally qualified residents. In order to acquire the freehold of a residential property, a purchaser must meet the requirements under the Control of Housing and Work (Jersey) Law 2012. Non-resident investors who do not qualify under this Law may nevertheless purchase share transfer properties (see above), but will not ordinarily be able to occupy without the necessary consents.

The commercial real estate market in Jersey is more accessible, with foreign investors being able to freely acquire commercial assets, although certain transactions (e.g., freehold acquisitions by corporate entities and the leasehold acquisition of mixed-use properties with residential units) may still require the prior consent of the States of Jersey Housing Minister. The implementation of the Control of Housing and Work (Jersey) Law 2012 in July 2013 has simplified the process of acquiring commercial real estate by significantly reducing the number of commercial real estate transactions that require ministerial consent.

IV STRUCTURING THE INVESTMENT

The structure of each transaction involving Jersey real estate will ordinarily be determined by the tax and accounting requirements of the investor, and it is advisable to obtain specific advice on the tax implications both in Jersey and in the investor's home jurisdiction. Internal corporate or investment restrictions may also dictate how an institutional investor is permitted to acquire an interest in Jersey commercial property.

i Corporate entity

Foreign investors can acquire the freehold of Jersey commercial property directly into their existing structures; however, it is usual for non-resident investors to establish a Jersey company to be used as a special purpose vehicle to acquire and hold the asset. Where the freehold is already held by an existing company, investors may wish to acquire the asset indirectly (by acquiring the issued shares) which in some circumstances can minimise exposure to stamp duty and goods and services (GST).

Under the current 'zero/ten' income tax regime, a company resident in Jersey will, subject to certain specific exceptions, be liable to income tax at a rate of zero per cent. The principle exception is income earned from Jersey real estate, which is liable to income tax at the (current) standard rate of 20 per cent. A non-resident landlord scheme provides for the withholding of tax from rental income (by either the tenant or the managing agent) unless the non-resident investor can obtain a certificate of good standing from the Comptroller of Taxes in Jersey enabling the rent to be paid without deduction (but subject to settlement of any tax due).

ii Partnership structures

Other investment vehicles, such as limited partnerships, are not often used to acquire Jersey real estate.

Jersey 'classic' limited partnerships are broadly equivalent to limited partnerships in England and Wales. They have no legal personality, and must have both at least one general partner (who is responsible for the management of the limited partnership and who has unlimited liability for the debts of the limited partnership) and one limited partner (whose liability is limited to the amount they have agreed to contribute to the limited partnership but who may not take part in the management of the limited partnership without losing such limited liability). Jersey separate limited partnerships are similar, but are more akin to Scottish limited partnerships in that they have legal personality. Incorporated partnerships (which are bodies corporate) have also recently been introduced.

Jersey limited partnerships are transparent for the purposes of Jersey income tax. Accordingly, non-Jersey resident limited partners of Jersey limited partnerships are assessed for Jersey income tax in their own names. Their liability to Jersey income tax is limited to Jersey-source income. The receipt of any monies in respect of non-Jersey situate assets (such as non-Jersey situated real property) does not constitute Jersey-source income for these purposes.

iii Trust of Jersey real estate

The law of trusts in Jersey is largely based upon the law of England and Wales, but with several important differences. In particular, it is not possible to have a trust of immoveable property in Jersey. The Trusts (Jersey) Law 1984 renders invalid any trust that purports to apply directly to immoveable property situated in Jersey. This does not, however, prevent a Jersey law-governed trust from acquiring and holding shares in a property holding company.

V REAL ESTATE OWNERSHIP

i Planning

The statutory framework for planning in Jersey is embodied within the Planning and Building (Jersey) Law 2002, and the orders and regulations made pursuant to that Law. The island's planning regime is plan-led, and the principal policy document is the Island Plan 2011. The Island Plan designates zoning parameters and outlines policy considerations for specific planning applications.

Any construction or redevelopment project undertaken within the island must be carried out in accordance with the Planning Law, and will ordinarily require planning permission and building by-laws consent. Consent for change of use may also be required. There are certain exempt development provisions, but these primarily relate to residential property.

ii Environment

The customary law of *voisinage* (neighbourhood) regulates the relationship between neighbours and offers some protection to property owners from damage caused by a neighbouring owner. This area of law is relatively undeveloped, but there have been some recent cases heard before the Jersey courts.

The customary law is supplemented by a statutory regime, which primarily relates to the prevention and regulation of environmental contamination. In general, those who cause or knowingly permit land to become contaminated will be responsible in the first instance. Developers who purchase sites that have a history of contamination may be required, as part of the planning process, to remediate the site to such standard as may be required by the relevant authorities.

The States of Jersey Eco-Active initiative aims to assist organisations to ensure that they are meeting environmental obligations. The initiative is an environmental accreditation scheme that is tailored to local environmental laws and sensitivities. The scheme is, however, closely aligned with environmental business schemes in the United Kingdom.

iii Tax

GST

Depending on the nature of the property and the GST status of the parties to the transaction, GST may be payable. A supply of commercial real estate is a taxable supply, and will be subject to GST at the standard rate. The current standard rate of GST in Jersey is 5 per cent. Where commercial real estate is purchased subject to commercial leases, and the property is being acquired as an investment, the acquisition may (subject to certain conditions being met) be treated as a transfer of a going concern that does not attract GST.

Residential real estate is generally zero rated for GST purposes. There are exceptions to this treatment where the property is registered as either a guesthouse or lodging house under relevant Jersey legislation. It is recommended that advice be sought at an early stage of any proposed acquisition to clarify the permitted use of the property and the GST implications of the relevant transaction.

Stamp duty and land transactions tax

Stamp duty is payable on all acquisitions and transfers of Jersey real estate, and is assessed on an *ad valorem* basis unless the transaction in question benefits from specific relief. The amount of stamp duty payable is calculated by reference to the higher of the purchase price, or the gross value of the property where the property is gifted or transferred for non-monetary consideration.

The current stamp duty rates in Jersey are as follows:

Consideration/value of the property	*Stamp duty (as at 1 January 2014)*
£50,000 or less	0.5 per cent per £100 or part thereof (subject to a minimum of £10)
£50,000 to £300,000	£250 in respect of the first £50,000 plus £1.50 per £100 or part thereof in excess of £50,000
£300,000 to £500,000	£4,000 in respect of the first £300,000 plus £2 per £100 or part thereof in excess of £300,000
£500,000 to £700,000	£8,000 in respect of the first £500,000 plus £2.50 per £100 or part thereof in excess of £500,000
£700,000 to £1 million	£13,000 in respect of the first £700,000 plus £3 per £100 or part thereof in excess of £700,000
£1 million to £1.5 million	£22,000 in respect of the first £1 million plus £3.50 per £100 or part thereof in excess of £1 million
£1.5 million to £2 million	£39,500 in respect of the first £1,500,000 plus £4 per £100 or part thereof in excess of £1.5 million
In excess of £2 million	£59,500 in respect of the first £2 million plus £5 per £100 or part thereof in excess of £2 million

Unless otherwise agreed, stamp duty is payable by the purchaser or transferee of the property, and must be paid in full prior to the registration of the relevant contract before the Royal Court of Jersey.

There are a number of concessions that may apply, but these will rarely be available for commercial real estate. There is no intra-group relief from stamp duty in Jersey, although there are provisions enabling charities to benefit from reduced stamp duty rates.

Stamp duty is not payable on the acquisition or transfer of shares in a company that owns commercial real estate. However, the acquisition or transfer of a share transfer property (see above) may be subject to the payment of land transactions tax, which is broadly the same as the amount of stamp duty that would be payable if it were a freehold purchase.

iv Finance and security

There are several ways in which real estate transactions may be financed in Jersey. The most common means of financing is direct financial assistance from a lender to enable an investor to acquire a specific property. The nature of the security package required by a lender will depend on the nature of property, the structure of the transaction and the proposed debt-to-equity split. The primary security required by most lenders is a judicial hypothec (a charge) secured over the Jersey real estate in question.

To secure a judicial hypothec over Jersey real estate, a borrower must sign a security document known as a billet that acknowledges the borrower's indebtedness to the lender. This billet is then registered before the Royal Court of Jersey by the lender's lawyers. This registration creates a hypothec over the property. Hypothecs can be drafted so as to be specific (i.e., secured over one property) or general (i.e., attaching to all Jersey real estate owned by the borrower at the date of registration).

In share transfer transactions, as the purchaser acquires shares in a Jersey company, share security will be required by a lender. Share security is created by a Jersey law-governed security agreement. From 1 January 2014, following the enactment of the Security Interests (Jersey) Law 2012, lenders will for the first time be able to register a statement of their secured interest over shares in a Jersey company on the public register to be administered by the Jersey Financial Services Commission. This new process of recording security has been welcomed by the finance industry.

In financing transactions involving commercial property, it is not unusual to see a combination of both the above forms of security. In addition, some lenders may look to take security over development agreements, building contracts or rent receivables.

VI LEASES OF BUSINESS PREMISES

The parties to a commercial lease are broadly free to agree such terms as they wish, free from statutory intervention. Recent challenging market conditions have resulted in landlords offering significant incentives to tenants, such as rent-free periods and break rights. In transactions involving refurbished or newly constructed premises, the parties often enter into agreements to lease that commit the parties to completing the lease on the satisfaction of specific conditions. Usual provisions included within leases of business premises are as follows:

i Term

The term of commercial leases can vary greatly, depending on the parties' requirements. Until relatively recently, it was common for leases of office and retail premises to be granted for terms in excess of 21 years. In recent years, tenants have been able to dictate the length of the term, which has resulted in an increase in shorter-term, more flexible commercial lettings. One determining factor is stamp duty: contract leases (those with a term of nine years or more) are required to be registered in the Public Registry and attract a charge to stamp duty. Shorter-term paper leases do not require to be registered, and do not attract a charge to stamp duty.

Contractual break options may also be included (usually at the option of the tenant), although options to extend the term are rarely seen.

ii Rent and rent increases

While there is no industry norm, three or five yearly rent reviews are most common. Rent reviews are ordinarily stated to be on an upwards-only basis, and may be determined by reference to local market rent, cost of living increases (by reference to the Jersey Retail Prices Index), turnover or a mixture of all of these.

iii GST

The grant of a lease for commercial premises is considered to be a taxable supply for the purposes of GST (depending on the GST status of the landlord). Leases entered into (or varied) since the implementation of GST in August 2007 will ordinarily contain provisions allowing the landlord to recover GST from the tenant. The GST status of the tenant may also have a bearing on the requirement to recover GST.

iv Tenant's alienation and change of control

Provisions restricting the tenant's ability to deal with the premises (and the lease) will often be included, subject to landlord's consent. Landlord's consent may be subject to specific conditions, but is ordinarily stipulated not to be unreasonably withheld, delayed or conditioned.

Change of control restrictions are not a common feature of commercial leases in Jersey, although landlords are increasingly seeking to try and incorporate clauses that require notification of such changes.

v Tenant liability and security for payment of rent and performance of covenants

There is no statutory obligation on a tenant to continue to be liable for its obligations under a lease following assignment, whether under an authorised guarantee agreement or otherwise. The position under Jersey customary (common) law is unclear. The usual practice is to include an express release of the tenant (and its guarantor) within any assignment documentation.

vi Repair and insurance

A lease for a whole building will usually see the tenant responsible for the maintenance and repair of all internal and external parts. Multi-let buildings and shorter-term leases generally require the tenant to maintain and repair the internal parts only of their demise, with the landlord being responsible for common parts and structure of the building – and recovering its costs through a service charge. The tenant's contribution to the service charge is ordinarily calculated by reference to the net internal area of the demise as a proportion of the net internal area of the building.

It is usual for the landlord to be responsible for maintaining buildings insurance, on terms agreed between the parties. A proportion of the insurance costs are generally recovered from the tenant.

vii Collateral warranties

For properties that have been recently constructed or refurbished, collateral warranties from the professional and design teams of the developer are ordinarily available to purchasers and their funders. There are usually restrictions on the number of times such collateral warranties can be assigned. Tenants assuming repairing obligations for the structure of a building (or a newly completed fit-out) will often request the benefit of collateral warranties. Unless specifically agreed, there is no obligation on the landlord to deliver such warranties to a tenant.

viii Termination

Leases terminate automatically at the end of the contractual term (or earlier, if agreed between the parties). It is also usual for the agreements to include specific events that give rise to a right to terminate (such as insolvency of the tenant, non-payment of rent or other fundamental breach by the tenant of its obligations). To formally cancel a lease, however, it may be necessary to obtain an order from the Royal Court of Jersey.

ix Security of tenure

The Landlord and Tenant Act 1954 does not extend to, or apply in, Jersey. There is no equivalent legislation providing a statutory right of security of tenure. A tenant of commercial premises has no right to remain in occupation beyond the expiry of the term. In the event that a tenant remains in occupation but continues to pay rent, there may be an argument of *tacite reconduction* – being the presumption that the parties have entered into a new lease on the terms of the expired lease.

VII DEVELOPMENTS IN PRACTICE

i Control of Housing and Work (Jersey) Law 2012 (the CHWL)

The CHWL came into force on 1 July 2013, and represents a significant change in the regulation of the property and employment sectors in Jersey. The CHWL consolidated restrictions on persons working in Jersey and their ability to own or occupy property. It is the cornerstone to the States of Jersey's migration policy.

The CHWL provides a framework for controlling Jersey's population and the availability of work and housing in the island. It replaced the previous Housing (Jersey) Law 1949 and the Regulation of Undertakings and Development (Jersey) Law 1973.

Of particular interest to the real estate sector, the CHWL removed the requirement for the consent of the Housing Minister to real estate transactions, subject to a few exceptions. The principal exception is in relation to corporate entities acquiring commercial, residential or mixed-use real estate by freehold purchase, in which circumstances Ministerial consent will still be required.

Under the CHWL, residential properties in Jersey are designated as either qualified or registered. The designation of the property dictates who can buy or occupy those properties. An individual's status under the CHWL will be one of registered; licensed; entitled for work only; or entitled.

In summary, only individuals who are licensed or entitled may purchase and occupy qualified (residential) accommodation.

ii Security Interests (Jersey) Law 2012 (the SIL)

The SIL was approved by the States Assembly on 19 July 2011 and received Privy Council assent on 10 July 2012. The SIL updates and improves the current law relating to security interests in intangible moveable property.

From 1 January 2014, the key change to transactions involving Jersey real estate will be the ability of a lender to record its secured interest on a public register. While primarily relevant to share transfer properties, the SIL will also have implications for commercial real estate financing transactions where the lender requires security over intangible moveables, including shares, rent receivables and contract rights.

iii Green leases

While far from common, landlords are increasingly looking to ensure that their leases include provisions encouraging sustainable occupation and management. Jersey's exposure to green leases is largely the result of foreign investors implementing practices and procedures used in other jurisdictions. It is becoming more common for institutional investors to insist that properties across their portfolio have leases drafted on similar terms; therefore, leases of Jersey real estate are increasingly being drafted so as to include green provisions.

In practice, this development has been largely viewed as positive, and new construction projects are being commissioned with environmental efficiency and ratings being at the forefront of the design process.

iv Private lending

More robust lending criteria imposed by high-street lenders has led to an increase in private individuals providing finance for transactions involving Jersey real estate. This trend is likely to continue throughout 2014. The inherent risks of this type of transaction for a private lender are reflected in the rates of interest being required, which can be between 6 and 10 per cent. Opportunities may exist for foreign investors to participate in this market, although careful advice needs to be taken to ensure that adequate security is obtained and investors are aware of the enforcement procedures and remedies available in Jersey.

VIII OUTLOOK AND CONCLUSIONS

It is hoped that the higher levels of activity in the Jersey real estate market experienced during Q3 and Q4 of 2013 will continue during 2014. Several significant commercial developments will be commenced in the island, with a particular focus being in and around the St Helier Waterfront and Esplanade quarters. These developments will provide a supply of high-quality office, retail and hospitality premises together with a generous residential offering. It is hoped that Jersey's reputation as an international finance centre together with the political drive to attract new business to relocate to Jersey will continue to provide tenants for these new developments.

There is a stated intention for the States of Jersey to maximise the use and development of publicly owned areas of land and to encourage redevelopment. This, in conjunction with the adoption by the States of Jersey of detailed master plans, it is anticipated will lead to the rejuvenation of significant parts of the island. This will necessarily involve a mixture of public and private investment, which will contribute to the growth of the local real estate market.

Recent upward trends in the tourism sector have led to reinvestment in retail and hospitality assets. Increased take up of retail space by internationally recognised retail brands appear to be signs of cautious optimism. Significant investment in hotel premises is likely to continue, given the increased number of seasonal visitors to the island.

Chapter 20

KOREA

Kyung Don Lee, Robert C Young and Eun Nyung Lee[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

The Korean legal system is based on civil (codified) law similar to that of Germany, France and Japan, with some influence from the American legal system in certain areas such as the Korean bankruptcy and rehabilitation laws. Ownership under Korean law is based on complete ownership (similar to fee simple absolute under common law), which entitles the owner to do whatever he or she wishes with the property, including the right to exclusive possession, use, encumber and transfer. Korean law does not recognise any other possessory real property interests such as a defeasible fee simple estate, fee tail, life estate or future interest in land. Real estate can also be owned by one or more parties in Korea. Generally, co-ownerships are held under the form of a *gong-yu*, *hap-yu* or *chong-yu*,[2] and in cases of any purchase of property that are held under a co-ownership, the purchaser should be careful that the seller (or sellers) has, or has otherwise secured, the authority to dispose of the property or his or her interest therein.

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2 The most common form of co-ownership in Korea is the *gong-yu*, which is similar to the common law concept of tenancy in common where two or more persons are owners of undivided (in some cases, divided) interests in the property (such interests are indicated as ratios to the whole property), with each co-owner holding an estate in the property by separate and distinct titles but with unity in the possession, use and right to the whole property in proportion to their respective interest in the property. *Hap-yu* is ownership of property through a partnership that is not recognised as a legal entity, but is rarely used. *Chong-yu* is ownership by members of a group (which is not a recognised legal entity), such as a religious organisation.

Under Korean law, real property consists of land and buildings, which are considered separate real property. The relevant units used to measure ownership of land and buildings are *pil-gee* and *dong* (which is equivalent to one building structure), respectively. In principle, potential buyers are not allowed to acquire interests that are smaller than one *pil-gee* or one *dong* unless a building is deemed an aggregate building[3] and the *dong* has been divided into several sections that are subject to independent use or ownership.

ii System of registration

Korea has a dual registration system for real property consisting of a land registry and a building registry. Ownership interests must be registered under the applicable registries, because land and buildings thereon are considered separate real property.

If a person wishes to acquire an ownership interest or establish a security interest, such person must register the relevant documents with the appropriate registry office to perfect the transfer of title (except where it arises by operation of law) or to establish a security interest. The priority order of the security rights established on the real property will depend on the order of the registration date.

The registration system is governed by the courts and managed by the registration division of the court administration department at the Supreme Court. The registry may be viewed on, and printed from, the Supreme Court website. An entry is made in the register after administrative procedures are completed. To avoid fraud or abuse, the entry procedure is guarded by certain protective measures, such as only holders of the relevant property identification number and password being allowed to enter any change in information. However, unlike in other jurisdictions that have adopted a more strict system, there is no strict formality, such as executing a sales or transfer deed before a notary public, to transfer title or make any other type of entry into the register. As such, while registration in the real property registry creates a strong presumptive evidence of valid ownership, it is not conclusive.[4]

3 An aggregate building is a building that is structurally divided so that the divided sections (strata titles) can be independently used or owned (Article 1 of the Act on the Ownership and Management of Aggregate Buildings). The aggregate building and its divided sections must be separately registered before any transactions involving its use or ownership can be legally effected.

4 Under Korean law, registration in the real property registry is a strong presumptive evidence of ownership. However, there are some inherent limitations to verifying ownership under the Korean recording system, and should there be any material defect in the chain of title for a certain parcel of real property, the right of the current title holder may be challenged. To avoid purchasing a property with a defect in the chain of title, the entire chain of title needs to be checked. Even if there is a defect in the chain of title of the property, anyone who has been registered as an owner of the property for at least 10 years, and who has openly and uninterruptedly occupied such property for at least 10 years in a way that a real owner would occupy its property, will be deemed to have had valid title to the property under the Korean Civil Code.

iii Choice of law

The main bodies of law that govern real estate transactions are the Civil Code, the Commercial Code, the Act on the Ownership and Management of Aggregate Buildings, and the Real Estate Registration Act. Depending on the nature and circumstances of the transaction, laws that govern permits, zoning and approvals, such as the Building Act and the National Land Planning Act, or laws that govern qualifications of the buyer, such as the Foreigner's Land Acquisition Act, the Foreign Investment Promotion Act and the Foreign Exchange Act, may also apply.

In special cases, the real estate transaction may be subject to the Industrial Complex Act, the Act on Free Economic Zones, the Protection of Military Bases and Installations Act, and the Farmland Act.

II OVERVIEW OF REAL ESTATE ACTIVITY

i Real estate funds (REFs)

In 2004, REFs were introduced in Korea as an investment vehicle after certain amendments were made to the Indirect Investment Asset Management Business Act. Many investors embraced the concept of REFs and began widely using them as investment vehicles for real estate transactions. Private REFs are especially popular, since only one or more persons are required for the formation of the REF. However, under the amended Financial Investment Services and Capital Markets Act, commencing from January 2015, at least two or more persons will be required for the establishment of the REF.

The table below shows that the total number of REFs has been steadily increasing for the past five years, due mostly to the increase in private REFs.

	Dec 2008	*Dec 2009*	*Dec 2010*	*Dec 2011*	*Dec 2012*	*Dec 2013*
Public offer (100 million won)	11,377	8,560	8,915	8,512	10,484	10,982
Private offer (100 million won)	77,525	107,028	132,398	155,783	188,529	221,008
Total (100 million won)	88,902	115,588	141,313	164,294	199,012	232,070
No. of REFs (Private REFs)	252 (238)	298 (290)	317 (308)	342 (334)	408 (394)	470 (455)

(Source: Korea Financial Investment Association)

ii Real estate investment trusts (REITs)

REITs[5] have become one of the more widely used real estate investment vehicles, as shown in the table below. Recently, REITs have become particularly popular in projects involving the development of officetels (multi-purpose buildings with residential and commercial units), developments, hotels, supermarkets, department stores, and retail

5 Although the name 'trust' is used, the REIT is actually not a trust but a stock corporation.

and discount stores. In the first half of 2013, nine REITs were established in Korea for the purpose of investing in department stores, office buildings, hotels, educational institutions and residential units. In addition, for the first time in Korea, a REIT was established for the purpose of investing in the leasehold rights (not the ownership rights) of real estate property. While such REIT does not have the benefit of receiving any sale proceeds that may arise at the time of dissolution of such fund, the investors would be entitled to receive a constant stream of dividends through the security right attached on the owner's right to receive rent payments from its tenants.

	Jun 2008	*Jan 2009*	*Sep 2010*	*Feb 2011*	*May 2012*	*Jul 2013*
Total capital (100 million won)	23,673	24,905	35,912	39,832	41,799	– *
Total assets (100 million won)	49,045	48,837	72,565	74,106	82,339	– *
No. of REITs	21	20	42	65	75	73

(Source: Ministry of Land, Infrastructure and Transport (MOLIT); * MOLIT did not disclose the total capital and total assets amount in its July report)

iii Project financing vehicles (PFVs)

PFVs are one of the most common forms of investment vehicles used for real estate development projects. However, it is difficult to ascertain accurate data and information relating to PFVs, as PFVs are not governed by a central agency such as the National Tax Office, but are governed separately by their relevant local tax office.

iv Foreigner real estate transactions

Following the steady increase in foreign investments in Korean real estate following the 1997 Asian financial crisis due to, *inter alia*, changes in laws that permitted foreigners to directly own property in Korea and the increase in the amount of real estate for sale, the 2008 global financial crisis saw foreign investment slow down. While the level of impact of the global financial crisis has been limited in Korea, it had an impact on the traditional foreign real estate players, including many of the American and European financial institutions and real estate funds. However, as shown below, the level of foreign investment has since regained some momentum since 2009.

	2008	*2009*	*2010*	*2011*	*2012*	*2013 (until November)*
Land (m^2)	8.544 million	13.456 million	11.130 million	9.904 million	10.605 million	11.508 million
Buildings (m^2)	526,000	941,000	679,000	697,000	805,000	730,000

(Source: MOLIT)

III FOREIGN INVESTMENT

Under the Foreigner's Land Acquisition Act (the FLAA), a foreigner wanting to acquire land in Korea must file a report or obtain an approval (in some exceptional cases such as acquisition of land located in military facilities protection areas, cultural relics protection areas, etc.). A foreigner is defined under the FLAA as:

a a person of foreign nationality (foreign national);
b a corporation or organisation established in accordance with the laws of the foreign country (foreign corporation);
c a corporation or organisation established in Korea where 50 per cent or more of its shareholders and members are foreign nationals; and
d a corporation or organisation established in Korea where 50 per cent or more of its capital or voting rights are held by a foreign national or a foreign corporation.

i Acquisition of land by a foreigner

Prior to 26 June 2009, a foreigner was required to report the acquisition of land in accordance with the procedures set forth in the FLAA. However, following amendments to the FLAA, any foreigner that acquires land on or after 26 June 2009 may be exempt from filing a land acquisition report as long as such foreigner chooses to file the more simple real estate transaction report with the relevant mayor's office, regional office or local district office in accordance with the Act on Certified Broker's Business and Real Estate Transaction Report. In the event that a non-resident foreigner wishes to acquire land, in addition to filing a land acquisition report or a real estate transaction report, the non-resident foreigner must file a real estate acquisition report under the Foreign Exchange Transaction Act for the inflow of foreign currency.

ii Acquisition of land by a foreign-invested Korean corporation

The Foreign Investment Promotion Act governs the registration by a Korean corporation as a foreign-invested corporation where it meets a certain percentage of investment level by foreigners, and offers certain taxation and procedural benefits. These Korean corporations, as corporations duly established under the laws of Korea, would ordinarily acquire land in the same manner as any other Korean national or corporation. However, as the FLAA defines certain corporations as foreigners, and in such cases applies the same rules applicable to foreigners, a foreign-invested Korean corporation regarded as a foreigner under the FLAA must also complete the land acquisition notice or the real estate transaction notice.

iii Certain benefits to foreign-invested companies

Certain tax and non-tax benefits are available to foreign-invested companies. For example, a foreign-invested company may be eligible for incentives or exemptions from acquisition tax, registration tax and property tax (reduced to as low as zero and for up to 15 years) for the acquisition of land in a designated foreign investment zone, or if such foreign-invested company provides certain qualified high technology that supports the competitiveness of Korea.

Moreover, as the government continues to foster foreign direct investment, some municipalities have provided opportunities to foreign-invested companies to purchase land at a lower than market price (but not lower than appraisal value) and without going through a bidding process. Despite certain formalities and restrictions that apply to such transactions, the attractive price and ability to acquire the property without undergoing a bidding process means that many municipalities are currently involved in development projects in which land has been supplied to foreign-invested companies. It should be noted, however, that the Audit Board of Korea has recently warned against the abuse of such system where foreign financing is being disguised as an equity investment (for instance, an equity investment with a guaranteed yield and put option) for a domestic company to acquire property from the municipalities at lower than market price and without going through a bidding process. Legislation to further restrict such abuse is also being considered.

IV STRUCTURING THE INVESTMENT

The government introduced new indirect investment vehicles in 2000 in an attempt to stimulate and attract investor activity in the Korean real estate market. In practice, the most widely used investment vehicles are as follows.

i REITs

A REIT is essentially a joint-stock company (*chusik hoesa*) that has been established by investors for the purpose of earning (e.g., rent, gain on sale or development) and distributing profits. The establishment and operation of REITs are regulated by the Real Estate Investment Company Act.

REITs are subject to the following measures under the Real Estate Investment Company Act. Some investors consider such measures to be too restrictive and prefer the use of the more flexible REF:

a the REIT shall offer at least 30 per cent of its shares to the general public within six months of obtaining business approval;

b the REIT shall not have any single shareholder that owns more than 30 per cent of the shares in the REIT;

c the REIT shall only take in-kind contributions of up to 50 per cent of the capital of the REIT;

d the REIT shall become a listed company if it meets the qualifications of a listed company under the Financial Investment Services and Capital Markets Act;

e the REIT shall distribute not less than 90 per cent of its maximum dividend limit of the relevant year to its shareholders (the REIT shall receive a corporate tax deduction if it distributes 90 per cent or more in dividends);

f the REIT shall not dispose of its newly acquired real estate within one year (three years for housing) unless the real estate was created or built pursuant to a real estate development project; and

g the REIT shall invest only within 30 per cent of its total assets if it plans to invest in a real estate development project.

The Real Estate Investment Company Act recognises three different types of REITs: self-managed REITs (SM-REITs), consigned-management REITs and corporate-restructuring REITs (CR-REITs). Since their introduction, CR-REITs have been popular among investors (in 2013, 29 out of 73 REITs were CR-REITs). This is because, unlike the other REITs, CR-REITs are:

a exempt from the public offering requirement;

b exempt from the listing requirement;

c not subject to a cap on the maximum ownership by a single shareholder; and
d are entitled to a corporate tax deduction if it distributes 90 per cent of more in dividends to shareholders, even though it is restricted from disposing of acquired real estate within one year.

CR-REITs are not suitable for most real estate transactions, because at least 70 per cent of the total assets of the CR-REIT must be invested into real estate for corporate restructuring purposes.

SM-REITs are unique in that shareholders are allowed to directly participate in investment and management decisions of the REIT through shareholder or board meetings. However, SM-REITs were rarely used by investors because they were deemed 'corporations' and were not only required to operate like corporations (i.e., hire full-time staff, employees), but were not entitled to receive corporate tax exemptions like the other REITs. In an attempt to promote further use of REITs and SM-REITs, on 13 July 2007, the Ministry of Land, Infrastructure and Transport (MOLIT) introduced development-oriented REITs that allowed investment of their entire assets into real estate development projects even prior to being listed. Under the present law, development-oriented REITs may be structured in the form of an SM-REIT, consigned-management REIT or CR-REIT. The implementation of development-oriented REITs has contributed to the growth of SM-REITs, as more investors have established development-oriented SM-REITs within the past five years than ever before (as of July 2012, there were 10).

On 31 December 2011, MOLIT introduced a new set of amendments to the Real Estate Investment Company Act intended to provide investors with more flexibility in using REITs. For example, the amendments relaxed the requirement that SM-REITs must have at least five employees with asset management expertise at the time of establishment to only three employees at the time of establishment and a total of five employees within six months of establishment; and allowed for another type of REIT structure, the parent-subsidiary real estate investment trust (parent-sub REIT), in support of institutional investors. To qualify as a parent-sub REIT, national pension plans and other similar associations stipulated in the Real Estate Investment Company Act must own more than 50 per cent of the equity interests in the parent-REIT, which in turn owns more than 50 per cent of the equity interests in the subsidiary REIT that owns real property. Unlike other REITs, parent-sub REITs are exempt from the public offering requirement, as well as the 30 per cent limitation on the maximum equity ownership by a single shareholder.

ii REFs

REFs are collective investment vehicles that invest more than 50 per cent of their equity interests in real estate. REFs are governed by the Financial Investment Services and Capital Markets Act.

Unlike REITs, REFs are not subject to requirements such as public offering, listing, dividend distribution, capital contribution limits and maximum ownership caps on single investors, and, at their own discretion, may invest all of their assets in a real estate project. In addition, REFs may be structured in the form of a trust, a corporation or an association. For these reasons, REFs are currently the most popular collective investment vehicles used by investors in Korea. Although there are some drawbacks, such as limited investor participation in investment decisions, these are relatively minor considering that other REITs (e.g., consignment-REITs and CR-REITs) are also subject to similar limitations, and blind-type REFs (i.e., no oversight by investors) are almost non-existent in the Korean marketplace. It should be noted that investors are not allowed to repurchase or redeem their shares after investment in a REF unless the trust securities (trust-type REF) or equity securities (corporation-type REF) become listed.

In Korea, the most common type of REF formed by investors is the trust-type REF. While there are no key differences in benefits or advantages, it appears that investors prefer the relative ease of forming a trust-type REF over a corporation-type REF.

iii PFVs

A PFV is a joint-stock company established for the purpose of engaging in the business of 'facility investment, social indirect capital facility investment, development of resources or any other specially designated business that requires a considerable investment of time and capital and distribution of earnings to its shareholders'. The PFV is basically a paper company, and shall not have any employees or persons serving as officers or full-time directors. Although the PFV is governed by the Commercial Code as a special purpose company, it is privy to certain tax benefits under the Corporate Income Tax Law of Korea, such as exemption from acquisition tax and corporate income tax (i.e., if it distributes 90 per cent or more in dividends).

PFVs have been widely embraced by investors, and are commonly used in real estate transactions over REITs. The key advantages of PFVs are as follows:

a easy establishment process (REITs require approval from MOLIT, while PFVs only require a report to the relevant tax office);

b no mandatory categorisation of business (unlike REITs, PFVs do not need to indicate in their corporate name their business as a real estate investment vehicle);

c no reporting requirements (REITs are required to submit a quarterly business report to MOLIT, while PFVs are not subject to reporting requirements to any authorities);

d no public offering or listing requirements;

e no in-kind contribution caps; and

f no dividend requirements (even though they may enjoy certain tax benefits if they are distributing 90 per cent or more dividends).

In addition to the many advantages, PFVs are particularly attractive among investors as they are also allowed to participate in the decision-making process of investments.

Some minor drawbacks of PFVs are that they are real estate investment vehicles mostly reserved for large development projects, they are paper companies that are established to meet temporary milestones, and the qualifications for being recognised as a PFV are still unclear.

iv Asset-backed securitisation

An asset-backed securitisation company (ABS company) is a limited liability company (*yuhan hoesa*) that acquires real property and, based on this underlying asset, issues ABS securities (i.e., senior bonds, junior bonds, equity) to the bondholders and equity owners. ABS companies are regulated under the Asset-backed Securitisation Act.

To be recognised as an ABS company, a party must establish a limited liability company or register itself as a trust with the Financial Services Commission, and submit information to the Financial Service Commission, including the name of the company or trust, the assets under ownership, the expected duration of ownership and a business plan outlining the management, operation and disposition of the assets. While the amount of information required and the strict approval process may seem cumbersome to certain investors, ABS companies are among the more popular investment vehicles, as they provide numerous tax benefits.

V REAL ESTATE OWNERSHIP

i Planning and zoning

The main body of law that governs the use and development of real estate is the National Land Planning and Utilisation Act. According to this Law, the relevant offices of each metropolitan city (e.g., Seoul, Busan), city (e.g., Suwon, Pyung-taek) and county (e.g., Go-seong) shall devise a general use and management plan for their respective domains. Included in the general use and management plans are designated zoning areas (e.g., residential, industrial, farming), designated zoning districts (e.g., scenic districts, fire prevention districts, preservation districts) and designated zoning sections (e.g., green belt sections, city park sections). In some cases, a parcel of land may be subject to multiple designations (e.g., land designated for farming may also be deemed a preservation district). While the general use and management plan also regulates the type of buildings and structures that may be constructed and used on the land (e.g., purpose, lot coverage, height), it is the Building Act that regulates and approves the actual construction, re-modelling and expansion of the building on the land.

The Act on the Maintenance and Improvement of Urban Areas and Dwelling Conditions for Residents primarily focuses on providing systemic and regular services to improve and develop the quality of life of residents in outdated and run-down urban areas. According to this Act, the city shall evaluate areas that require maintenance and improvement, and reflect those areas in the general maintenance and improvement plan for urban and residential areas, which is produced every 10 years. Areas that are designated for maintenance and improvement will receive necessary services once qualified contractors are approved by the city.

The planning and execution of much larger-scale urban projects (i.e., the re-zoning of an entire city) are governed by the Urban Development Act. Once a city is qualified to undergo urban development, an area will be designated as a development area, and the central government, municipal government and landowners will form a consortium and become the general contractors of the project.

Real estate transactions that involve the development and use of storage and logistical facilities are regulated under the Act on the Development and Management of Logistics Facilities. This Act was enacted by the government to implement highly efficient and competitive logistical infrastructure within Korea. To meet such purpose, the Minister of Land, Transport and Maritime Affairs must publish an overall plan detailing its agenda every five years, and persons who wish to operate multi-purpose logistical terminals (i.e., a terminal capable of supporting more than two transportation modes) must register with the Minister and submit a construction plan that includes the details of the structure and facilities to be built. The Minister has the authority to designate logistics facilities, and any developer that wishes to engage in the development and management of logistics facilities must be appointed by the Minister as the general contractor, and may commence construction after submission and receipt of approval of a development plan of logistics facilities.

ii Environment

The Framework Act on Environmental Policy provides that the central government has the duty to work in concert with municipal governments and public agencies to preserve and protect the environment from pollution by using preventive, restorative and punitive means. Individuals or businesses that are culpable of polluting the environment are subject to responsibility and shall, at their own cost, fully clean up and restore the environment to its original condition, subject to approval by the central government.

Soil contamination has long been a serious environmental issue in Korea. According to the Soil Environment Conservation Act, a party responsible for causing soil contamination must clean up and restore the contaminated areas. If multiple parties are involved, and it is unclear which party caused the contamination, the parties are jointly responsible for restoring the damages incurred. It should be noted that owners and their successors, and the operators of facilities that cause soil contamination, are responsible for any damages that may arise; however, the successor shall not be liable if the results of an environmental due diligence conducted prior to the transfer of ownership did not reveal that the facility was at risk of causing contamination.

Owners of facilities that are categorised as public use facilities must maintain a minimum air quality standard for their patrons. The air quality must be measured by the owner or a person qualified under the Code of the Ministry of Environment, and recorded for inspection purposes.

iii Tax

A person who acquires real estate is typically subject to an acquisition tax of 4.6 per cent. However, if the real estate is located in an area designated as an overpopulation control area under the Seoul Metropolitan Area Readjustment Planning Act, and is acquired by the purchaser's main office or branch office, the purchaser will be subject to an acquisition tax of 9.4 per cent within five years of such office's establishment in the overpopulation control area. Certain investment vehicles, such as the REF, CR-REIT, ABS and PFV, are not subject to the heavy amount of acquisition tax applied to an overpopulation control area, and are subject only to the 4.6 per cent acquisition tax.

iv Finance and security

The most common forms of security interest used by debtors and creditors in a real estate transaction are a mortgage and mortgage trust.

Mortgage
The debtor maintains ownership of the real property while the creditor is granted a security interest on the debtor's real property for providing a loan. The mortgage interest must be registered in the relevant title registry. If the debtor fails to pay back the loan, the creditor may enforce its security rights by requesting the court to auction the real property and, upon foreclosure, the creditor shall receive its relevant share of the auction proceeds subject to the creditor's priority rights.

Mortgage trust
The debtor's real property is transferred into a trust, whereby the trustee holds ownership of such property and the creditor is granted a priority interest on the trust proceeds. If the debtor fails to make the required loan payments, a public offering of the real estate shall be made available by the trustee, and the sale proceeds will be distributed to the creditors subject to their priority interests.

With respect to real estate development projects, various security measures, such as a pledge on shares issued by the general contractor, an agreement to transfer or relinquish the general contractor's development rights, the general contractor's joint liability, a pledge on insurance payments, and an agreement to transfer or assign general contractor's rights under the development contract, are also available to lenders.

VI LEASES OF BUSINESS PREMISES

The lease of business premises is permitted in Korea, and the leasehold rights of the landlord and tenant are governed by the Commercial Building Lease Protection Act. A common leasehold right that is often used in Korea is a unique leasehold right called a *jeonse*. In the case of a *jeonse*, the landlord receives a large key money deposit from the tenant (in lieu of no or small monthly lease payments) and, in return, the landlord allows the tenant to use the property for the period stated in the applicable lease contract. Upon the expiration or early termination of the lease term, the landlord must return the key money deposit to the tenant.

To secure the leasehold right and return of the key money deposit, a *jeonse-kwon* must be registered with the court having jurisdiction over the real property in question. In such case, if the landlord does not return the key money deposit to the tenant upon the expiration or termination of the lease term, the tenant may take action to foreclose on the property, regardless of whether such tenant holds a first priority security interest over the property, without securing a court judgment on the merits of the case. Upon completion of foreclosure proceedings, if auction proceeds resulting from such foreclosure proceedings were insufficient to pay the entire amount of the key money deposit to the tenant, the tenant will continue to have an unsecured claim against the landlord for the remaining balance of the key money deposit. Further, notwithstanding the foreclosure proceedings, the tenant must continue to pay monthly rent (if any) and management fees to the landlord until the tenant surrenders the premises and restores the premises to its original state.

According to the Civil Code, a lease is an agreement between a landlord and tenant. While the lessee may use the leased premises upon making certain lease payments (in some cases, security deposits equal to 10 times the amount of monthly rent are provided) to the lessor, if the lease is not recorded in the applicable registry, the lessee shall not have grounds to challenge the validity of such lease against a subsequent landlord (i.e., the subsequent landlord does not automatically assume the existing lease). Moreover, in the event the leased premises become subject to foreclosure, if the lease is not registered, the security deposit shall not be returned automatically to the lessee, as the lessee is deemed a general unsecured creditor, and the auction proceeds will be distributed to the creditors subject to their priority rights.

Unlike the Civil Code, if the leased premise is a commercial building and it is deemed that a lease exists according to the Commercial Building Lease Protection Act, lessees are entitled to special protections, as subsequent landlords must assume existing leases and lessees are granted first priority rights for the return of their security deposits to a certain limited extent permitted by the Commercial Building Lease Protection Act.

VII DEVELOPMENTS IN PRACTICE

i Financial Investment Services and Capital Markets Act

Amendments were made to the Financial Investment Services and Capital Markets Act on 28 May 2013, and became effective on 29 August 2013. One priority was to amend the definition of collective investment. Prior to the amendments, the term collective investment was defined as monies collected through solicitations for investment made to two or more persons; as such, regardless of actual investment, any solicitation for investment made to two or more persons was deemed a collective investment.

Under the amendments, 'collective investment' is now defined as monies collected from two or more investors, which means that, to qualify as a collective investment, there must have been an actual investment by two or more investors. As a result of this change in definition, dissolution of a collective investment scheme will now be required where the number of investors is reduced to one. However, being a single investor will not lead to dissolution of the collective investment scheme in certain exceptional cases, and a grace period of one month from the date when such collective investment scheme is established or the number of investors is reduced to one will be provided.

Although the relevant amendments will come into force as of 1 January 2015, the amendment to the definition of collective investment will not affect a collective investment scheme established prior to 1 January 2015 with only one investor (i.e., the dissolution requirement will not apply) as long as no additional collective investment certificates are newly issued by such collective investment scheme after 1 January 2015 (i.e., the effective date of the amendments). If additional certificates will be issued for capital injections (including issuance to the existing investor) after 1 January 2015, it will have to be issued to at least two investors.

ii Real Estate Investment Company Act

On 4 June 2013, amendments were made to the Real Estate Investment Company Act, which became effective on 19 June 2013. Under the amendments, if a REIT invests all of its assets in the leasing business of multi-unit dwellings, such company will be exempted from the obligation of publicly offering its shares and the ownership restriction of a single shareholder (e.g., 30 per cent in a self-managed REIT).

In addition, under amendments made on 16 July 2013 and effective on 17 January 2014, a REIT should employ an appraiser to appraise the real estate in question and report the results to the Minister of MOLIT to gain approval of its business, and the Minister of MOLIT should examine the eligibility of the major shareholder who holds more than 5 per cent of the outstanding shares of a self-managed REIT as part of the process of confirming that the self-managed REIT has met the minimum capital requirements under the Real Estate Investment Company Act.

iii Commercial Building Lease Protection Act

Amendments to the Commercial Building Lease Protection Act (the CBLP Act and, as amended, the Amended CBLP Act) were promulgated on 13 August 2013. The purpose of the amendments is to further protect commercial tenants. The Amended CBLP Act is applicable to lease agreements newly entered into or renewed after 13 August 2013 (with certain exceptions).

The Amended CBLP Act recognises a tenant's right to renewal of its lease agreement, even if such tenant's lease deposit exceeds the amount prescribed by the Presidential Decree of the CBLP Act (which was the threshold used to protect smaller tenants). In addition, the Amended CBLP Act includes a new provision that allows a tenant to request an increase or decrease of rent or lease deposit at the time of renewal, taking into account various factors such as the tax and public utilities for that building, rents and lease deposits of the surrounding commercial buildings, and other economic circumstances. Under the former provisions of the CBLP Act, such right of renewal was not available to tenants whose lease deposits exceed the amount prescribed by the Presidential Decree (e.g., 300 million won in Seoul). However, the Amended CBLP Act recognises a tenant's right to renewal, regardless of the amount of lease deposit, to the extent that the entire term (as extended) does not exceed five years. For renewal of a lease under which the lease deposit is lower than the amount prescribed by the Presidential Decree, it is not possible to increase the rent or lease deposit by more than 9 per cent. However, under the Amended CBLP Act, there is no specific limit on an increase of rents or deposits for large tenants, although the tenant has the right to request an increase or decrease of the rents or lease deposits at the time of renewal, considering taxes or other changes in economic circumstance. Given the foregoing, it is anticipated that rent increase issues will arise when a large tenant exercises its right to renew based on this new provision.

Under the CBLP Act, when a tenant requests renewal of a lease agreement, the landlord may only refuse to renew for justifiable reasons (e.g., if the tenant defaults on rent payments for three payment periods). However, landlords had been broadly relying on the general provisions as a basis to refuse tenants' renewal requests on grounds that buildings were scheduled for demolishment or reconstruction. To better protect tenants, the Amended CBLP Act now provides that the landlord can only refuse the tenant's request for renewal in cases where the relevant construction plan was specifically notified to the tenant at the time of execution of the lease agreement, where there is a risk of accidents, or where the building is required by law to be demolished or reconstructed.

Under the CBLP Act, if a commercial building was to be foreclosed, a small tenant with a secured leasehold interest and lease deposit was entitled to receive, in priority over any other persons with mortgage rights or other interests in such building, an amount determined by the Presidential Decree based on the economic conditions of the relevant region, to the extent that such amount did not exceed one-third of the price of the building. To better protect small tenants, the Amended CBLP Act has increased the upper limit from one-third to one-half of the price of a building. This amended provision came into effect as of 1 January 2014.

iv Housing Act

Amendments made to the Housing Act on 6 August 2013 will become effective on 7 February 2014. The main purpose of the amendments are:

a to adopt rental house management business for the purpose of facilitating the supply of rental houses and provide opportunities for private investors to participate in markets related to rental houses;
b to reduce the landlord's burden of management of a rental house;
c to provide the landlord with stable earnings;
d to provide the lessee with comprehensive rental house management services by introducing provisions such as registration of the rental house management business, purchase of insurance and supervision of rental house managers; and
e to revitalise housing developments by regional housing associations.

v Rental Housing Act

The Rental Housing Act was amended on 4 June 2013; the amendments have been in effect since 5 December 2013 and aim to:

a revitalise the supply of rental houses by introducing:
- land–leasehold rental houses, where rental house providers construct and supply rental houses on land leased by the constructor;
- *jeonse* (leasehold by *jeonse*) rental houses, where rental house providers such as the government sublease existing houses in urban areas upon leasing them through *jeonse* agreements; and
- quasi-public rental houses, with certain restrictions such as compulsory lease periods and limitations on rent increases; and

b reduce the lessee's economic burden by permitting payment in instalments in the case of rental houses provided by providers such as the government.

vi Act on the Promotion of Constructing Green Buildings

The Act on the Promotion of Constructing Green Buildings has been effective since 23 February 2013. Under this Act, the Minister of MOLIT must promulgate, on an annual basis, the energy consumption standards relevant to each type of building:

a if a developer wishes to construct a building, it must design the building so that it is compliant with the relevant energy consumption standards promulgated by the Minister, and the developer must submit documents evidencing thereof when applying for a construction permit;
b if a developer wishes to convert an existing building into a green building to promote efficient energy consumption, the existing building must be compliant with the above standards;

c if a developer wishes to construct a building[6] that has a total area of 500m^2 or more, the developer must apply for a construction permit, apply for an approval of the change of use or submit an energy saving plan as set out by the Presidential Decree if it wishes to amend the contents of the building registry; and

d if an owner or manager of a business facility (with total area of 3,000 m^2) or communal residence (located within a residential area that has 500 or more residences and has installed a database system for building energy and gas use) wishes to sell or lease such property, the relevant transaction document must be accompanied by an energy efficient grade report[7] that includes various measures such as the property's annual energy use and gas emission rate.

vii Corporate Tax Act

Amendments made to the Corporate Tax Act on 31 December 2011 have been effective since 1 July 2012. Under these, in order to be taxed at the reduced tax rate under the relevant tax treaty, foreign entities that earn income sourced in Korea are required to submit a request for the application of treaty-reduced tax rates to the relevant withholding obligor. Where the Korean-sourced income is paid through an overseas investment vehicle, such vehicle must submit to the withholding obligor:

a an overseas investment vehicle report; and

b a detailed statement on the beneficial owners of the income based on their request for the application of treaty-reduced tax rates.

However, foreign investors who invest in overseas depository receipts issued by Korean companies will be exempted from the obligation to submit a request for the application of treaty-reduced tax rates. Accordingly, foreign funds wishing to enjoy the benefits afforded by tax treaties in respect of their income from Korean investments (e.g., an exemption from tax on capital gains realised from the transfer of shares, and reduced tax on interest and dividends) are required to submit a list of the investors (beneficial owners) to the withholding obligor. Foreign funds that fail to submit such list may not be entitled to the tax treaty benefits.

Previously, interest on foreign currency denominated bonds issued in Korea was exempt from income tax or corporate tax. However, these exemptions are no longer available, pursuant to an amendment to the Special Tax Treatment Control Law, effective as of 31 December 2011.[8] The amendment applies to bonds issued after 1 January 2012.

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6 Certain properties, such as a single residence home, zoo or botanical garden, are exempt.

7 However, certain buildings that are located within maintenance areas as designated by the Act on the Maintenance and Improvement of Urban Areas and Dwelling Conditions for Residents, deemed outdated or defective pursuant to the Act on the Promotion of Constructing Green Buildings, or subject to an auction or similar type of sale procedure, are exempt from attaching an energy efficient grade report to their respective transaction documents.

8 It should be noted that foreign currency bonds issued overseas are still exempt from income tax or corporate tax. However, what constitutes 'issued overseas' is not absolutely clear.

It is uncertain whether a transfer of real property made by certain investment vehicles or special purpose companies (SPCs) constitutes an individual asset transfer, which is subject to VAT, or a comprehensive business transfer, which is not. This issue was important in the past because, if the Korean tax authorities view a transaction as a comprehensive business transfer as opposed to tax treatments by the seller and the purchaser, the purchaser may not be entitled to a deduction or refund of the VAT paid for VAT invoices received for such transfer, and the seller and the purchaser may be subject to certain penalties. On the contrary, if the Korean tax authorities view a transaction as an individual asset transfer when the seller and the purchaser file tax returns separately, the seller may be required to pay VAT, as well as penalties thereon. Due to this uncertainty, many disputes had arisen between sellers and purchasers regarding whether a transfer of real property constitutes a comprehensive business transfer.

However, effective from 15 February 2013, and pursuant to amendments to the VAT Law of Korea and the Presidential Decree thereof, the VAT paid by the purchaser for VAT invoices can be deductible or refundable even if the VAT invoices are received for VAT-exempt transactions, including comprehensive business transfers, if it is proved that the seller has fully paid the VAT collected from the purchaser to the tax authorities and an amended VAT invoice has not been issued. Therefore, after 15 February 2013, if the seller issues VAT invoices and fully pays the VAT collected from the purchaser to the tax authorities, the purchaser can deduct such paid VAT even if the transfer constitutes a comprehensive business transfer. As such, we believe that the VAT risks involved in the transfer of real property by certain investment vehicles or SPCs has been reduced significantly.

viii Ruling of the Korean Constitutional Court on lease term limits

Under the Korean Civil Code, a lease term shall not exceed 20 years unless it is a lease of land for the purpose of owning an extremely durable building or structure (e.g., a stone building), or a lease of land for the purpose of planting trees or producing salt. In all other cases, even if the parties contractually agree to a lease term exceeding 20 years, the lease term will only be valid for the maximum 20-year period.

On 26 December 2013, the Korean Constitutional Court ruled that the above Civil Code provision is unconstitutional on the grounds that the purpose of such law is unclear and that, although there may be some socio-economic benefits that justify, to a certain extent, the enactment of such law, it violates the principle against over-restrictions and is detrimental to the freedom of contract. As a result, the above provision is no longer effective. However, the scope of an acceptable lease term (e.g., in perpetuity or 100 years) remains to be seen until the above provision is amended or the Court renders a judgment that provides further guidance.

VIII OUTLOOK AND CONCLUSIONS

As outlined above, there have been many recent amendments to Korea's real estate-related laws that are intended to promote investments in real estate, and we expect that this will have a positive impact on real estate investments in 2014. We also witnessed a large number of divestments in 2013 from foreign financial investors and REFs in Korea, due in part to the impact of the global financial crisis in their own countries. The impact on Korean and domestic financial institutions and real estate players, including funds and asset management companies, has not been as severe, and as such domestic investors were much more active in the Korean real estate market. This trend has continued, but we are also seeing foreign investors and investments return to Korea, in particular in the areas of sale and leasebacks, shopping malls and hotels (which continue to be popular due in part to the rise in tourism from other parts of Asia, including China and Japan).

The acquisition of overseas properties in major countries (including Australia, Germany, the UK and the US) by Korean investors, including pension funds, financial institutions and REFs, has continued to increase. We expect that this trend will continue in 2014.

Chapter 21

LUXEMBOURG

Véronique Hoffeld and Marc Meyers[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

In Luxembourg, other types of ownership exist in addition to full ownership: usufruct and bare ownership. Usufruct is the right to use a property vested in another person (the bare owner). The usufructuary may use and take the benefits deriving from the property as long as the property's substance is not impaired. Bare ownership gives the owner the right to dispose of the property but not the right to use or benefit from it. Generally, the bare owner only recovers full ownership of the property on the death of the usufructuary.

Two other rights are of interest to investors, namely the surface right and the *emphyteusis* or long-term lease. The surface right gives the tenant the right to construct and own buildings on the land it has rented. On termination of the lease, the owners of the land repay the tenant the market value of the buildings it has constructed. The *emphyteusis* is a long-term lease for between 27 and 99 years giving the tenant a right *in rem*, and a right to make full use of the property, which may be freely assigned to third parties. Its main characteristic is that in exchange for a very moderate rental payment, the lessor becomes the full owner on termination of the lease of all the improvements and constructions made by the tenant.

Finally, easement is the right to use real property belonging to another person without owning it.

ii System of registration

According to Article 1583 of the Civil Code, a sale is complete between the parties and ownership is acquired as soon as the property and the price are agreed, even if the

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property has not yet been delivered or the price paid. The parties, however, may delay the date of transfer of ownership. Concerning enforceability against third parties, the Law of 25 September 1905 (as amended) on the transcription of real rights for the sale of immoveable property provides that the sale must be authenticated by notarial deed and recorded at the Mortgage Registry. The notary conducts a full search at the property registry and notifies the tax authorities of the property transfer to obtain tax clearance. The signed transfer deed is then registered with the Luxembourg Land Registration and Estates Department, which sends the deed to the Land Registry so that the new owner is duly registered.

iii Choice of law

Article 3 of the Civil Code provides that Luxembourg law is applicable to real estate situated in Luxembourg. The *lex rei sitae* principle, whereby real estate is governed by the law of the country where it is situated, also applies to the prerogatives attached to the rightholder, the power of disposal and use, rights concerning shared ownership schemes, the compensation obligation between the bare owner and the usufructuary, and all ways of acquiring real estate (e.g., acquisitive prescription) and contracts involving a right *in rem*.

II OVERVIEW OF REAL ESTATE ACTIVITY

As a result of Luxembourg's flexible legal and fiscal environment, it has become a very attractive territory for foreign investment. Inbound investment has slightly decreased owing to the financial crisis, and has shifted to prime locations, such as the Luxembourg City centre rather than the periphery. The investment market in 2013 was characterised by encouraging results, in particular due to the increase of the office real estate market.[2] Indeed, the Luxembourg office market represented the best last quarter since Q4 2008. The prime yield remains on a good level and stable at 5.75 per cent. The most important investment criteria are location, the lease term (a minimum of six years is preferred), the quality of tenants and the energy efficiency of buildings. The Jones Lang LaSalle Luxembourg office market report for Q4 2013 shows that the investment volume in this period exceeded expectations, qualifying as the best quarter of the year with a volume of €241.5 million, which is over six times more than that in Q4 2012. Over the entire year, the volume of transactions reached €685 million. The market has been boosted by large-scale transactions, and in particular by the transaction signed by the European Parliament, which represents the largest deal signed by a European institution in the past five years. As regards nationality, Belgian investors dominated the market with 37 per cent of the total volume, followed by domestic investors with 33 per cent, and French investors who re-entered the market with 22 per cent (the last transaction by French investors before this was in Q4 2010).[3] Concerning the vacancy rate, this declined further to 5.1 per cent, compared with 6.5 per cent in 2012.

2 Investment market figures are based on the Property Partners Q3 2013 market research report and the Jones Lang LaSalle Luxembourg office market for Q4 2013.

3 Jones Lang LaSalle Luxembourg office market report for Q4 2013.

Luxembourg is the leading fund centre in Europe (and the second-largest worldwide),[4] and has become a leading centre for the use of regulated and unregulated Luxembourg investment vehicles for structuring investments in real estate property located outside the country (see Section IV, *infra*).

III FOREIGN INVESTMENT

Except for applicable obligations resulting from Luxembourg anti-money laundering rules, there are no restrictions on investments in Luxembourg real estate by foreign investors or foreign-registered or foreign-controlled entities. Foreign nationals have the same rights as nationals regarding the sale, purchase, lease or holding of real estate on Luxembourg territory.

IV STRUCTURING THE INVESTMENT

Luxembourg offers a broad range of unregulated and regulated investment vehicles (authorised and supervised by the Luxembourg Financial Sector Supervisory Commission (the CSSF)), which cater for all investor needs.

i Unregulated structures

The most popular Luxembourg unregulated investment vehicle is the SOPARFI, which is an ordinary commercial company whose purposes are holding and financial activities. The SOPARFI is often used for cross-border investments in real estate (located outside Luxembourg). SOPARFIs that invest directly or indirectly in real estate are subject to corporate income tax and municipal business tax on their worldwide profit at a current aggregate rate of 29.22 per cent (for companies located in Luxembourg City) and a net worth tax of 0.5 per cent on their net asset value at 1 January. An annual minimum corporate income tax of €3,210 is in principle due from the SOPARFI. Dividends and gains from shareholdings in real estate companies are generally exempt under the Luxembourg participation exemption regime. Under the double tax treaties Luxembourg has concluded, SOPARFIs may also benefit from tax exemptions on income and capital gains deriving from foreign directly held real estate. If such exemption does not apply, expenses associated with the foreign real estate are deductible.

A SOPARFI, which is not subject to any risk diversification requirement and is available to any type of investor, sophisticated or otherwise, may be formed as one of the following:

a a public limited liability company (SA);
b a private limited liability company (SARL);
c a partnership limited by shares (SCA);
d a cooperative company in the form of a public limited liability company (Coop-SA);

4 Based on assets under management.

e a common limited partnership (SCS); or
f a special limited partnership (SCSp).

ii Regulated structures

Investors may establish a regulated real estate investment vehicle as an undertaking for collective investment (UCI), a specialised investment fund (SIF) or an investment company in risk capital (SICAR).

UCIs set up under Part 2 of the Law of 17 December 2010 on Undertakings for Collective Investment, with the aim of investing in real estate in accordance with the risk diversification principle (CSSF Circular 9 1/75), have proved very popular. They may take the legal form of a SICAV, a SICAF or an FCP, and all types of investors are eligible. Real estate UCIs are characterised by their tax neutrality, as they are exempt from corporate income tax and net worth tax. In addition, distributions made by UCIs are generally not subject to Luxembourg taxation, although they are subject to an annual subscription tax of 0.05 per cent.

The SIF, based on the Law of 13 February 2007 (as amended) on Specialised Investment Funds, is a lightly regulated, operationally flexible and tax-efficient investment fund structure, which has rapidly become the vehicle of choice for international investors. A SIF may be created as an FCP, a SICAV or a SICAF. While SIFs may cater for investments in almost any asset class, including real estate, they have to abide by a 30 per cent safe-harbour diversification requirement. SIFs are only subject to an annual subscription tax of 0.01 per cent on their net asset value, but may benefit from certain exemptions.

While UCIs and SIFs with a corporate form may benefit from certain double taxation treaties concluded by Luxembourg, UCIs formed as FCPs generally may not.

The SICAR, created by the Law of 15 June 2004 (as amended), is a vehicle specifically dedicated to private equity and venture capital investments, whether diversified or not. Although SICARs may not invest directly in real estate, they may nevertheless do so indirectly by investing through other entities. The SICAR, which like the SIF is reserved for qualified well-informed investors, may only invest in real estate qualifying as risk capital.

In general, SICARs are tax neutral. A SICAR formed as an SCS or SCSp is tax-transparent and not subject to corporate income tax, municipal tax or net wealth tax. SICARs with a corporate form (e.g., SA, SARL or SCA) are non-transparent vehicles subject to corporate income tax and municipal business tax; however, a SICAR will benefit from tax exemptions for income and capital gains realised on transferable securities, and for the return on cash held for up to 12 months pending investment in risk capital. Non-transparent SICARs are exempt from net wealth tax.

V REAL ESTATE OWNERSHIP

i Planning

Local and national planning control measures limit the owner's right to use and dispose of its land. The legal basis for planning control in Luxembourg is the Law of 19 July 2004 (as amended) concerning city planning. Article 7 of the Law provides that every locality must have an urban development plan, on the basis of which the mayor grants licences to build and fixes the requirements that must be met. The Kirchberg district of Luxembourg City, where a number of financial establishments and European institutions including the European Courts of Justice are located, is subject to specific rules that implement a global urbanisation concept applied by the Kirchberg Urbanisation and Development Fund. Due to their size or nature, some real estate projects also require a *commodo-incommodo* authorisation issued by the Ministers for the Environment, and for Work and Employment. Other authorisations may also be required, depending on the specifics of the project.

ii Environment

In Luxembourg, liability for contaminated land is governed by the Law of 20 April 2009 (as amended). It is based on the polluter-pays principle. The person responsible for contamination normally must bear all costs related to the decontamination, even if that person is no longer the owner or the occupier of the land. If the person responsible for the contamination cannot be identified, or is insolvent and has no insurance coverage, the public authorities will ultimately cover the costs of the decontamination.

In the case of land contamination, the polluter must immediately notify the competent minister and authorities and take the necessary preventive measures. If it fails to do so, the authorities may take the corrective measures they consider appropriate. The parties may agree contractually on who will bear the cleanup costs. Survival provisions in relation to long-time environmental liability are frequent. In the case of wilful misrepresentation regarding the pollution of the property, the purchaser may take legal action to request the cancellation of the contract or to claim compensation, or both. Criminal penalties may apply to both individuals and companies for the violation of environmental legislation.

iii Tax

Municipalities in Luxembourg impose a land tax of 0.7 per cent to 1 per cent on the unitary value of real estate, determined by reference to the value of a similar building in 1941. As a result, the land tax is very low. It is then multiplied by coefficients fixed by each municipality and varying according to the type of real estate. Stamp duties are also levied at various rates on the registration of notarial deeds. In addition to notarial fees, the buyer will pay a total of 6 per cent of the property's market value in registration fees (transfer tax), and 1 per cent of its market value in transcription duty (transcription tax). For real estate located in Luxembourg City, an additional charge of 3 per cent is imposed; exemptions are available, however. VAT is also applicable (under certain conditions, a rate of 3 per cent may be applied) on the sale of future constructions. Under certain conditions, it is also possible to opt for VAT on the sale of constructed properties, in which case VAT will be borne in addition to the transfer tax.

iv Finance and security

In Luxembourg, the main methods by which a lender seeks protection from default by a borrower are mortgages and pledges (if the real property is bought by means of an investment vehicle). The lender generally asks for a first-ranking mortgage on any type of specific property and leasehold property. The lender will also generally require, if available, a pledge over shares, a pledge over receivables from tenants, insurance proceeds and a bank account pledge. To secure the lender's ranking, however, an entry must be made in the mortgage register. Unlike certain other jurisdictions, Luxembourg law does not provide for floating charges.

VI LEASES OF BUSINESS PREMISES

Unlike residential leases, commercial and office leases are only regulated by some general provisions in the Civil Code, which means that the parties are generally free to agree on the terms of the lease. Rents for commercial and office leases are usually linked to and increased according to the consumer price index as published by the STATEC, the Luxembourg statistical institute.

The term of a commercial lease is freely negotiable between the parties; however, commercial leases are usually entered into for a term of three, six or nine years. If the lease does not specify a term, reference is made to local practice, which in Luxembourg is established by case law as three years. Commercial tenants may be entitled to a preferential lease renewal right for up to 15 years, on condition that they have been conducting their business in the premises for at least three years. Tenants of premises in which they conduct their business have a preferential right to request a new commercial lease for a fixed term before the contract expires. Lessors opposed to a renewal may raise one of the five objections exhaustively listed in the Civil Code: they can prevent the renewal if they can prove a real and truthful higher offer or legitimate grievances (left to the court's discretion), if they (or their relations) wish to occupy the premises themselves, if they wish to stop leasing them for a similar or analogous type of commerce, or in the case of construction or transformation.

The securities payable for commercial leases are more substantial than those for residential leases. A deposit of three to six months' rent is usually required. A deposit of three to six months will generally be required for offices, and a deposit of six months for commercial business premises such as shops. There is no legal provision laying down a maximum deposit.

Additional security such as a personal guarantee may also be required. In this case, a third party, commonly the manager of a limited liability company, will take over the tenant's debt if the tenant is unable to pay the rent. This security is rarely used, as lessors do not consider it very effective. Guarantees on first request, generally given by a Luxembourg-based bank, are usually adjudged as better security. The advantage of a guarantee on first request is that the lessor may at any time ask the bank that issued the guarantee to pay the debt. Certain court rulings have allowed banks to refuse payment when a request was considered to be clearly abusive, but those rulings were given under special circumstances and remain uncommon.

Office leases are usually concluded for nine years; however, the trend has recently been to renegotiate the lease when it is due to expire within the next two years, extend the period and reduce rental instalments. The new types of contract are in the tenant's favour (they involve free rental periods and offer fitting-out or refurbishing), and a term of three, six or nine years is now the usual practice.

VII DEVELOPMENTS IN PRACTICE

i Lessor-friendly legislation for office leases

Although rents initially agreed between landlords and tenants for residential leases in Luxembourg may be challenged by a tenant and potentially mandatorily decreased, down to 5 per cent on invested capital (see Section VII.i, *infra*), for leases on business premises (i.e., commercial and professional leases) the parties, particularly the landlord, are free to set the price and conditions. In Luxembourg, the parties generally conclude triple-net leases, which are very beneficial for the landlord as the tenant pays not only the rent, but also all taxes, insurance and maintenance expenses arising from the use of the property.

Rental income is generally exempt from VAT. If, however, the landlord and the tenant are subject to VAT, they may opt for VAT by filing a request with the relevant tax authorities. Financial sector professionals are generally not allowed to recover VAT in full and therefore do not use the VAT option. In such cases, it is common for landlords to increase the rent by 15 per cent, which is the current VAT rate in Luxembourg; however, landlords of residential leases are limited to a maximum 5 per cent return on the capital invested in the building, and the rental guarantee may not exceed three months' rent. These limitations do not apply to luxury dwellings having a modern standard of living, although the law's definition of modern standard of living is vague.

ii Extension of pre-emption rights under a pacte logement

The most recent and significant real estate law (the Law of 22 October 2008 that relates to a *pacte logement*, or housing agreement) aims to stabilise property prices by implementing a number of measures to encourage municipalities to increase the land and housing supply. Among the Law's most relevant aspects are the pre-emption rights granted to long-term lease tenants. The *pacte logement* may in certain circumstances provide a pre-emption right in favour of municipalities, the Housing Development Fund or the state. Municipalities benefit from a pre-emption right for certain zones, namely development zones, zones scheduled for restructuring, holding zones, land reserve zones and zones adjacent to agglomerations. The Housing Development Fund benefits from a pre-emption right for holding zones, land reserve zones and zones adjacent to agglomerations. Finally, the state benefits from a pre-emption right for land necessary to achieve the lodging management plan. If the owner decides to sell the property, the pre-emption right offers these entities a right of pre-emption. It must not be confused with an expropriation, as the owner must at some point have expressed its desire to sell; however, if the holder of the pre-emption right waives its right, the owner may then freely sell the property to someone else.

If the pre-emption rights are breached, the sale of the real estate may be declared null and void, and a court may rule that the holder of the pre-emption right is the legal owner of the property for the same price and conditions as provided for in the annulled purchase agreement. Legal action must be brought within two years from the registration of the purchase agreement.

The *pacte logement* also strengthens the surface right, and its holder now benefits from more prerogatives. It also extends the benefit of the registration tax credit to registration fees owed upon the constitution or disposal of a surface right or an *emphyteusis*.

iii Energy certification for functional buildings

A building is said to be functional if less than 90 per cent of its area is intended for housing. Shopping centres, supermarkets, shops, offices, restaurants, banks, universities and airports are classified as functional buildings. The Grand-Ducal Regulation of 31 August 2010 (as amended) concerning the functional performance of buildings lays down the methods for calculating a functional building's energy performance, the minimum requirements and the certification of its energy performance (Energiepass).[5]

Since 1 January 2011, an assessment of the energy performance (complying with the provisions of the Regulation) and the Energiepass are mandatory for any request for authorisation to build a new functional building or extend or modify an existing one. In specific cases (classified buildings, buildings of public interest, etc.), an exemption from the listed energy performance requirements may be obtained following a fully documented request.

iv Impact of International Financial Reporting Standard (IFRS) on the accounting of lease payments

Lease accounting (international accounting standard (IAS) 17) is traditionally based on the distinction between an operating lease and a financial lease. The distinction is based on the analysis of the transfer of risks and rewards linked to the ownership of the asset as substantially agreed by the parties. The lessee in a financial lease is considered as the economic owner of the asset and will therefore book the asset on the asset side of its balance sheet. A financial lease is analysed according to the criteria for the transfer of risks and advantages, and the lessee is considered as the economic owner if the economic property is transferred to him or her. With a view to enhancing transparency about a company's leasing activities, the International Accounting Standards Board (the IASB) is working on a project for IFRS rules that would affect the accounting treatment of leases. A revised Exposure Draft (with Basis for Conclusions and Illustrative Examples) was issued by the IASB and the Financial Accounting Standards Board (the FASB) in May 2013. The commenting period closed on 13 September 2013. The revised Exposure Draft proposes a dual approach to the recognition, measurement and presentation of expenses and cash flows arising from a lease. For most real estate leases, a lessee would report a straight-line lease expense in its income statement. For most other leases, such as equipment or vehicles, a lessee would report amortisation of the asset separately from interest on the lease liability. The IASB and the FASB are also proposing disclosures that should enable investors and other users of financial statements to understand the amount, timing and uncertainty of cash flows arising from leases. Comments letters are

5 Under Directive 2002/91/EC, similar provisions have applied since 1 January 2008 to residential buildings.

currently under review, and several public roundtable meetings have been jointly held by the FASB and the IASB.

The aim of IFRS is to ensure better comparability of the financial position of companies across the world.

v Taxation of speculative gains on real estate owned by individuals

When real estate is sold within two years of its acquisition, the capital gains realised are regarded as speculative and therefore taxed as ordinary income at the corresponding progressive rates. The capital gain basis to which the progressive rate is applied is the difference between the selling price and the acquisition price, increased by incidental costs. In this case, the deductible acquisition price will also be adjusted to inflation, thus further narrowing the taxable base. If the real estate is kept for at least 10 years, an additional €50,000 will be deducted for non-speculative capital gains. This amount is doubled when the property is owned by a married couple filing jointly. It is therefore advisable to hold a property for at least two years, as the tax rates on its sale drop to half the ordinary tax rate once this period has elapsed.

vi House prices increase

According to the latest Real Estate Observatory report, sale prices for houses and apartments in Luxembourg slightly decreased during 2012. Indeed, between Q4 2011 and Q4 2012, a decrease of 1.63 per cent was registered for houses and of 0.95 per cent for apartments.[6]

VIII OUTLOOK AND CONCLUSIONS

The real estate market in Luxembourg is benefiting from improved economic prospects and forecasts for 2014, which are especially encouraging concerning the growth of the commercial real estate market; based on positive results in the investment market, 2013 is considered to have been one of the best years since 2007.

In connection with the structuring of real estate acquisitions through Luxembourg investment vehicles (see Section IV, *supra*), the Luxembourg regulatory landscape has recently evolved with the transposition into Luxembourg law of Directive 2011/61/EU of the Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers (the AIFMD). The AIFMD aims to provide a harmonised regulatory and supervisory framework for managers of alternative investment funds (AIFs) within the EU. It sets rules regarding the organisation and business conduct of managers, imposes certain additional requirement on AIFs and allows their marketing to professional investors throughout Europe via a marketing passport. With the adoption of the implementing law of 12 July 2013 on alternative investment funds managers (the AIFML), managers of AIFs already active prior to July 2013 will have until July 2014 to become authorised by their relevant competent supervisory authority. Luxembourg has

6 Observatoire de l'Habitat activity report for 2012 dated June 2013.

favoured a flexible approach, which should allow the Luxembourg practice to meet the need for inventiveness in the alternative market.

The AIFML is not limited to a stand-alone implementation of the AIFMD; it also encompasses an amendment of the management companies legislation, as well as of the regulations for UCIs, SICARs and SIFs in light of the AIFMD requirements. In another major development, the AIFML has substantially reformed the partnership law through a modernisation of the current limited partnership (SCS) with legal personality and the introduction of a limited partnership without legal personality, the special limited partnership (the SCSp). The aim of the partnership reform was to replicate in the Luxembourg environment the features of Anglo-Saxon limited partnerships, which generally offer a high degree of contractual freedom and full tax transparency and neutrality to fund initiators.

The AIFML has also embraced the option offered by the AIFMD to expand the scope of eligible depositaries beyond financial institutions in respect of AIFs that have no redemption rights exercisable during a period of five years from the date of the initial investments and that, in accordance with their investment policy, do not invest in financial instruments or invest in issuers or non-listed companies to potentially acquire control. For those AIFs, the status of a depositary of non-financial assets (PFS custodian) has been introduced by the AIFML under the Law of 4 April 1993 on the financial sector. Hence, when appointing a Luxembourg depositary, such AIFs will have the option of appointing either a CSSF-approved credit institution (or other eligible institution) or a PFS custodian. On the tax side, the AIFML has also introduced some changes to the Luxembourg taxation of carried interest, aimed at favouring the relocation of fund managers to Luxembourg.

Finally, it should be noted that the 'investment entities'[7] amendment to IFRS 10, IFRS 12 and IAS 27 applies, for accounting periods commencing on or after 1 January 2014, to listed companies and companies having chosen to prepare their consolidated financial statement according to IFRS. According to this amendment, a parent company that is an investment entity shall not, as a principle, consolidate its subsidiaries or apply IFRS 3 when it obtains control of another entity. Instead, such investment entity will be required to measure an investment in a subsidiary at fair value through profit or loss in accordance with IFRS 9.

7 An investment entity is an entity that obtains funds from one or more investors for the purpose of providing those investors with investment management services; commits to its investors that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and measures and evaluates the performance of substantially all of its investments on a fair value basis.

Chapter 22

MEXICO

Benjamin C Rosen[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

The acquisition of real estate in Mexico by foreign investors requires adherence to strict formalities established by the Mexican Constitution, laws and civil law tradition.

Article 27 of the Constitution grants ownership of Mexico's land and water to the Mexican nation, which, in turn, has the power to transfer rights over the same to its citizens, thereby creating private property. The Constitution further stipulates that foreign citizens may, in general, acquire dominion over land, provided that they agree before the Secretariat of Foreign Affairs to consider themselves as Mexican nationals with respect to such property and not to invoke the protection of their home government in the event of controversy. If this pact is violated by the foreigner, all rights to the property shall revert to the nation. Commonly found in Latin American countries, this provision is known as the Calvo Clause.

Moreover, the Mexican title system is not as technologically advanced as its counterparts in developed countries. Title reports from public registries may sometimes be unreliable or inaccurate, and in most states registrars lack modern computer filing systems or records, thereby making them vulnerable to human error and corruption. Traditionally, the Mexican *notario público*, a quasi-public official who attests to the legality and authenticity of the transaction, has played the most important role in ensuring the transfer of clean title. However, many major US title insurance companies now offer coverage in Mexico. This coverage is welcomed by foreign buyers, because it provides them with recourse and indemnification in the event that a title dispute were to surface; however, it is not a substitute for the role of the notary, insofar as the latter still formalises the transaction, but now with the availability of a backstop from the insurer.

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i Ownership and recordation

Ownership of real estate in Mexico, including the resolution of controversies related to real property interests, is governed by the civil code of the state[2] in which the property is located, regardless of whether the parties choose any other applicable law by contract or otherwise.[3] There is also a Federal Civil Code, which applies to property located in the Federal District and property under the jurisdiction of the federal government. Although state civil codes and the Federal Civil Code are in most instances substantially similar with respect to real property law matters, it is important to consult the civil code of the state in which the property in question is located prior to consummating a transaction in that particular state.

The most common types of real property interests recognised by the Civil Code are, *inter alia*:

a fee simple ownership (*propiedad plena*);
b usufruct (i.e., the right to use, enjoy and exploit real property);
c leasehold;
d mortgage;
e pledge;
f easements; and
g rights of accession (i.e., rights to improvements on real property).

Ownership can be acquired by government grant, conveyance, will, intestate succession or prescription (i.e., adverse possession). The conveyance of real estate in Mexico is consummated simply upon buyer and seller executing a contract of sale in which the price and the item sold is stipulated.[4] Nevertheless, for the transaction to be effective before third parties, it must be formalised in a public deed and duly recorded in the Public Registry, referred to as the principle of notice.[5]

This record-notice doctrine is particularly crucial in Mexico because the recording process typically takes between two and six weeks to accomplish. To bridge the gap and prevent any third party from acquiring rights between the execution and the actual recording of the deed, Mexico's civil codes and public registry laws have created the preventative notice, which is a document issued by the notary formalising the transaction in which he or she advises the Public Registry that the property in question is subject to

2 Mexico has 32 states plus the Federal District.

3 Article 13, Federal Civil Code. Although local law must be applied to resolve the controversy for any judgment to be enforceable locally (i.e., if specific performance is sought or if the defendant has assets locally to be attached to satisfy a judgment), the parties are free to agree by contract to an alternate forum, such as binding arbitration.

4 Article 2248 and 2249, Federal Civil Code. The same concept and similar text of such article is reproduced in the civil codes of all Mexican states.

5 Thus, if a third party acquires rights to the same real estate previously sold but not recorded and has no actual or constructive knowledge of the prior unrecorded sale, then the third party who records first will be deemed a buyer in good faith whose rights will be superior to those of the party acquiring first but not recording.

sale, and requests that the notice be recorded in the Public Registry, thereby constructively notifying the world of the conveyance and 'freezing' title until the deed is executed and recorded.

In addition, there is a strong presumption under Mexican law that the person who possesses property owns it,[6] which gives rise to an abundance of squatter and adverse possession claims and a general difficulty in evicting holdover tenants.

II OVERVIEW OF REAL ESTATE ACTIVITY

Following several years of recovery from the 2008 real estate and financial crisis, the Mexican real estate market – including the residential, leisure (including tourism, resort and hospitality), commercial and industrial segments – is again experiencing solid and stable growth, with investment increasing at approximately 4 per cent to 5 per cent per annum since 2010. This growth is due primarily to increased demand as a result of a growing economy and, starting in 2013, availability of both consumer and developer financing at reasonable rates. In fact, Mexican residential mortgage rates in pesos hit 9 per cent, the lowest figure in history, which is a tribute to both the stability of the residential segment and the currency, while, for example, the Mexico development bank BANCOMEXT is offering tourism project financing for the construction of new hotels, timeshare resorts and other job-creating real estate projects at LIBOR plus 4 per cent to 5 per cent.

Likewise, foreign investment in Mexico continues to grow. Just from 2012 to 2013 (and not considering the last quarter of 2013), total FDI increased almost 250 per cent, with a peak in the second quarter of 2013 of US$18.9 billion.[7]

Despite these improvements, several factors have kept the industry from experiencing even more robust growth. First, approval of several new development capital bonds called CKdes and real estate investment trusts (REITs) called FIBRAS (discussed below) poised to inject over US$1 billion into the Mexican real estate capital markets has been held up by regulators. Second, Mexican foreclosure laws and judicial procedure enable delinquent borrowers to retain control over assets long after default, thereby increasing the cost of money and risk to lenders, and preventing more foreign lenders from entering the market and offering rates similar to those offered in their home countries. Finally, although Mexico continues to attract millions of international tourists to its hotels and resorts every year (Mexico is ranked 12th in the world in this category), the country is still shouldered with the burden of a poor image and security issues in certain parts of the country caused by rampant drug and organised crime violence, which, in turn, has slowed growth in all segments, but most particularly leisure.

6 Article 798, Federal Civil Code.

7 Ministry of Economy, official FDI statistics: www.economia.gob.mx/comunidad-negocios/competitividad-normatividad/inversion-extranjera-directa/estadistica-oficial-de-ied-en-mexico.

III FOREIGN INVESTMENT

In addition to the Calvo Clause, Article 27 of the Constitution further restricts the ability of foreign nationals to acquire property in Mexico by prohibiting their direct ownership of land within the Restricted Zone.

i Acquiring property in the Restricted Zone

The Restricted Zone encompasses all land and water located within 100 kilometres of any border and 50 kilometres of any sea.[8] No foreign nationals may acquire direct title over real property within the Restricted Zone. However, Mexico's Foreign Investment Law allows foreign nationals to acquire indirect title to land in the restricted zone by one of two methods:

a through a Mexican corporation[9] owned and managed by foreign nationals (provided that the property owned by the corporation is not for residential purposes);

b through a trust form referred to in Spanish as a *fideicomiso*,[10] with a Mexican bank acting as trustee and the foreign buyer as beneficiary.

If the property in question is located outside the Restricted Zone, foreign individuals and entities may acquire direct, fee simple title (i.e., without employing a Mexican trust or company). However, to limit liability and due to the practical restrictions imposed on foreign entities and individuals doing business in Mexico, most foreign investors choose to take title to all Mexican real estate via a Mexican entity or trust regardless of the location.

Many state governments offer tax incentives to attract new investment, such as waiving payroll taxes and real estate acquisition taxes (discussed below) if the investor commits to invest certain sums of money in the state. However, often a requirement to be eligible for the incentive is that the investing entity be organised or domiciled in the state in question. These incentives are more prevalent in states with a large industrial and in-bond plant base aiming to gain a competitive advantage over other states than in states where tourism is the predominant industry.

8 Article 27, Constitution; Article 2, Foreign Investment Law.

9 Like the trust beneficiary, the Mexican corporation must include the Calvo Clause in its articles of incorporation and must provide notice to the Secretariat of Foreign Affairs upon acquiring land in the Restricted Zone.

10 The *fideicomiso* (trust) is a three-party contract through which the transferor (trustor) irrevocably transfers title to real property to a Mexican bank (trustee) so that the foreign citizen (beneficiary) can use and enjoy the property and dispose of it if and when desired. See Article 381, General Law of Credit Instruments and Transactions and Article 11, Foreign Investment Law.

IV STRUCTURING, FINANCING AND SECURING THE INVESTMENT

Foreign investors purchasing and developing real property in Mexico will usually form a Mexican subsidiary, regardless of whether a trust is employed, so as to limit the liability of the foreign parent company or shareholders, or both, and enable the venture to conduct business fluidly in the country. Passive foreign investors, however, may be content with holding a beneficial interest in a Mexican trust without forming a subsidiary.

A Mexican trust can be used for many other purposes in addition to the ordinary restricted zone trust for residential purposes discussed above. For instance, the Mexican development trust offers tax benefits to sellers, insofar as it enables buyers to acquire land from sellers conditionally, and as long as the trust agreement stipulates that title reverts back to the seller if the buyer fails to fulfil all conditions (such as payment of the entire purchase price, sharing in the profits of each sale or delivering title to a unit in the completed development), then the conveyance into the trust *per se* does not constitute a sale triggering capital gains.[11] Likewise, guaranty trusts are a common form of securing a loan with Mexican property.

i Debt versus equity

Foreign real estate developers will typically rely on both equity (for the acquisition) and debt (for the development) of the asset. Indeed, undeveloped land loans are virtually non-existent in Mexico, although once the property is acquired free and clear, today many Mexican and foreign lenders – both institutional and private – are eager to finance the construction and development of viable projects by proven developers offering good returns and sufficient collateral.

If financing for the acquisition and development of the property is structured and collateralised outside of Mexico (or if it is a cash purchase), the Mexican subsidiary will, in turn, usually acquire direct title to the Mexican property and no trust or security instrument is necessary.

However, the norm is for foreign investors in Mexico to develop with debt and for lenders – both Mexican and foreign – to require a security interest over the Mexican assets granted under local law. In turn, the Mexican guaranty trust is the preferred vehicle for providing the security interest in the land as well as all improvements, receivables and other personal property collateral.

Under this structure, the lender is the guaranty beneficiary, the Mexican subsidiary of the foreign investor is the use beneficiary, the Mexican financial institution[12] is the trustee, and the seller (or the beneficiary, if the collateral is already owned by the borrower) is the settlor. Once the loan is repaid, the use beneficiary or subsidiary can

11 Article 117 of the Federal Income Tax Law.

12 Unlike common law jurisdictions where lawyers, asset managers and other non-institutional parties can serve as trustees, in Mexico, almost all trustees are Mexican banks, and they must be authorised as such by the Mexican Banking and Securities Commission. Indeed, it is possible (although not common) for the same bank to be both the trustee holding legal title to the property and the lender holding a security interest in the property as guaranty beneficiary.

then either cause the lender to be removed from the trust or extinguish it and vest title in itself.

Another option is to grant the lender a traditional mortgage, but Mexican mortgage laws and foreclosure proceedings and appeals process are notoriously slow, sometimes taking up to five years from notice of default to execution of the judgment (i.e., judicial sale, eviction, or both). Because of this, delinquent borrowers often choose to fight foreclosure simply to gain an advantage in negotiating a settlement with the lender. In contrast, the guaranty trust offers expedited administrative foreclosure and a framework that enables borrower and lender to tailor the terms of the loan, repayment and foreclosure. In any case, for added security, foreign creditors are advised to require both parent guarantees and personal guarantees when lending into Mexico.

In contrast to debt, foreign equity sources usually prefer to structure and capitalise the venture under the laws of their own country, due to:

a greater familiarity and comfort with the laws of their home country;
b the rigidity of Mexican company law, under which preferred returns, equity waterfalls and in general quasi and preferred equity structures under which an investor receives returns disproportionate to its ownership interest are not easily structured; and
c a preference that disputes be resolved under the laws and in the courts of the investors' home country.

Thus, equity will usually form and structure the investment vehicle (in the US, usually via a pass-through LLC) in the investors' home country, and then this vehicle will serve as the parent company of the Mexican subsidiary, injecting the necessary cash into the subsidiary so it can acquire and develop the asset.

V REAL ESTATE OWNERSHIP

i Planning

Authority over the development and use of land in Mexico is shared by the federal government, states and municipalities.

The Constitution vests the municipalities with, *inter alia*, powers to:

a formulate, approve and administer urban development plans and zoning;
b authorise, control and oversee the development and use of land;
c participate in the formulation and administration of regional development plans and ecological reserve zones, together with the state and federal government; and
d grant construction licences and permits.[13]

In most instances, land use and zoning is governed by urban development plans and variances are subject to the approval of the majority vote of the City Council.

This broad municipal jurisdiction over land use is shared, however, with the federal government. Indeed, federal environment law requires owners to present and

13 Constitution, Article 115, Section V, subparagraphs c, d, f and g.

obtain authorisation from the federal environmental secretariat, SEMARNAT, of an environmental impact statement (EIS) with respect to all real estate developments affecting coastal ecosystems and all projects involving high-risk (including most industrial and some commercial) activity. Once the EIS is granted, a series of mitigation measures must be followed, or the authorisation could be revoked. Likewise, before clearing and developing land outside urban areas, a special change of land use permit must be processed before the National Forestry Commission, CONAFOR, and the technical feasibility and land use compatibility of the project requires the approval of the state government.

ii Environment

Mexican law stipulates that owners are jointly and severally liable with the party causing the contamination of land, even if the owner had no knowledge of the contamination upon acquisition.[14] Moreover, the officers and directors of a company can be held personally liable – both civilly and criminally – for the company's violation of environmental laws if they participated in the act or omission.[15] In addition, legislation has recently been enacted enabling citizen suits to enjoin and seek damages from parties violating environmental laws,[16] as well as class actions.[17]

iii Real property acquisition tax

All individuals or companies purchasing real estate in Mexico are subject to the payment of a real estate acquisition tax, regardless of purchaser's nationality or the chosen acquisition vehicle. This tax is calculated at a rate varying between 2 per cent and 3.7 per cent (depending on state law) of the purchase price or the municipal appraised value, whichever is greater. Some exceptions, apply, however. For example, in most states, acquisition by donation, intestate succession or will is levied at a lower rate or is exempt from the tax, and, in the case of trusts, no tax is due if:

a the trustor and beneficiary are the same;

b the property is settled into a trust simply to appoint a guaranty beneficiary as a mechanism to secure a loan (guaranty trust) or to manage the development of the property (administration or development trust); or

c a reverter clause is contained in the trust (i.e., a conditional transfer).

iv Finance and security

The two most common ways of securing a loan with real property in Mexico are a mortgage and a guaranty trust.

A mortgage is an agreement whereby the debtor or a third-party obligor grants the creditor the right to collect an amount due via the real property put up as collateral, which right may be exercised if the debtor breaches its obligations pursuant to the credit

14 Article 25, Federal Law of Environmental Balance.

15 Article 24, Federal Law of Environmental Balance.

16 Articles 13, 17, 24, 28 and 56, Federal Law of Environmental Balance.

17 Id.

agreement or note. Mortgage agreements must be executed before a Mexican notary public and recorded in the Public Registry of Real Property. Once recorded, the 'world is on notice' that the subject collateral has been encumbered to secure the payment of the debt referenced in the mortgage instrument.

On the other hand, a guaranty trust is an agreement whereby a debtor or third-party obligor (trustor) transfers title to collateral to a Mexican trust institution (trustee) for the benefit of the creditor (beneficiary). That is, instead of the debtor conserving title to the collateral and encumbering it in favour of the creditor, the trustee holds the temporary title to the property in order to secure the debtor's compliance with his or her obligations.

VI LEASES OF BUSINESS PREMISES

A lease exists under Mexican law when the lessor is obligated to grant the temporary use and enjoyment of property and the lessee is obligated to pay a defined price for such use and enjoyment.[18] Some key aspects of commercial lease law are as follows.

Commercial leases cannot exceed a term of 20 years,[19] but the parties are free to stipulate the right of the lessee to enter into a new lease for an additional term. Unlike residential leases, there are no policy restrictions on rent increases of commercial premises, and thus freedom of contract prevails.

To obligate the lessee to pay the rent throughout the term of the lease, even if the lessee elects to vacate early, the agreement should expressly stipulate that the term is binding on both parties. To further secure the lessee's obligation to pay rent, commercial lessors will typically require the lessee to either post a bond or provide as collateral other real property owned by the lessee or a third-party guarantor, called a *fiador*, who becomes obligated to pay the rent if the lessee fails to do so.

Leases that are for a term of longer than six years or that contemplate pre-payment of more than three years' rent should be recorded in the Public Registry,[20] which gives added protection to the lessee; in any case, leases are binding on all the lessor's successors in interest, so if the lessor sells the property, the purchaser acquires it subject to the lessee's rights. The same applies to intestate or legitimate succession.

Leases must be in writing; if they are not, the lessor has the burden of proving the agreed rent and other contract terms. Lack of definition of the term of the lease renders it a month-to-month agreement, in which case the lessor can demand the return of the leased premises upon 15 days' advance written notice.[21] In leases with a term that is longer than five years, the lessee enjoys the right of first refusal to purchase the property in the event that the lessor elects to sell.[22]

18 Article 2398, Federal Civil Code.

19 Id.

20 Article 3042, Paragraph III, Federal Civil Code.

21 Article 2478, Federal Civil Code.

22 Article 2447, Federal Civil Code.

In general, freedom of contract prevails with respect to which party pays for improvements and repairs, although the lessee's right to compensation cannot be waived with respect to repairs necessary for the use and enjoyment of the premises. Similarly, the lessor is obligated to perform the following, unless otherwise expressly provided in the lease:[23]

a deliver the leased premises to the lessee in a state apt for the agreed use (although the parties can stipulate, for example, that the lessor delivers a shell and the lessee is obligated to pay for the costs of finishing it);
b keep the premises in the same state throughout the lease and perform the necessary repairs (although the parties will commonly contract regarding this);
c refrain from interfering with the use or occupation of the leased premises, unless to perform urgent and indispensable repairs;
d guarantee the lessee's use and peaceful enjoyment of the leased premises for the term of the lease; and
e indemnify the lessee for pre-existing defects in the leased premises.

Likewise, lessees are generally obligated to:

a pay the rent in the time and manner agreed;
b indemnify the lessee for damages caused to the premises due to the fault or negligence of the lessee and its agents and sub-lessees; and
c employ the leased premises solely for the authorised use or in accordance with their natural purpose.

The lessee cannot sublease or assign the lease without the consent of the lessor, and if subleased, the lessee shall be jointly and severally liable with the sub-lessee or assignee for all damages.[24] Even when the sublease is authorised generally in the lease, the lessee remains jointly liable to the lessor under the lease.[25] In contrast, if the sublease is authorised in a separate written agreement, then the sublease is deemed subrogated in all rights and obligations of the lessee.[26]

Leases are governed by the laws of the state where the subject property is located,[27] even if the contract provides otherwise.

VII DEVELOPMENTS IN PRACTICE

i Constitutional reforms to allow direct foreign ownership of residential property near Mexico's beaches and borders

In 2014, Article 27, Section I of the Constitution will likely be amended to allow foreigners to own direct, fee simple title to residential real estate along Mexico's beaches

23 Article 2412, Federal Civil Code.

24 Article 2480, Federal Civil Code.

25 Article 2481, Federal Civil Code.

26 Article 2482, Federal Civil Code.

27 Article 13, Federal Civil Code.

and borders. The constitutional amendment – which has already passed Mexico's lower house, and is currently before the Senate – would allow foreign nationals to acquire direct title to homes, condominiums and residential lots in the Restricted Zone, which will result in a simplified and less expensive closing process, and additional security for the foreign buyer through the elimination of the third-party trustee as the holder of legal title. However, foreign nationals who purchase real estate with an economic, commercial, business, industrial or agricultural purpose would still be required to take title via a trust or a wholly-owned Mexican subsidiary. Thus, for instance, a developer of a residential real estate project on a beach aiming to sell to foreign buyers will still need to take title via a Mexican trust or company, but a foreign buyer of a condominium, house or lot will be able to take title directly as an individual. The amendment, and the resulting sense of consumer confidence in the Mexican legal system, is likely to trigger increased foreign consumer demand (and therefore investment by developers, both domestic and foreign) for second homes and vacation properties in Mexico's beach resorts (including Los Cabos, Puerto Vallarta, Cancun and the Riviera Maya).

ii Tax reforms affecting real estate

Effective from 1 January 2014, significant reforms to Mexico's Tax Code entered into effect,[28] many of which directly impact the real estate industry – most negatively and only one positively – as outlined below.

a The law on business flat tax (IETU) was repealed: this Law, which essentially taxed positive cash flow at a rate of 17.5 per cent even if no income tax was due on the same revenue, created significant tax liabilities for investors and developers who purchased assets prior to 1 January 2008 (the date the Law entered into effect) and then subsequently sold them because, even if the seller were to sell at a loss, the acquisition cost could not be deducted for IETU purposes, and thus the seller had little real negative cash flow to set off against the cash collected on the sale.

b Value added tax (VAT) in the border region rises from 11 per cent to 16 per cent,[29] VAT in the rest of the country was already 16 per cent, but the border region has always enjoyed a reduced rate because of completion from imports and the proximity to foreign markets where sales or VAT tax is lower. The 16 per cent rate now applies throughout the country. The border region includes the state of Quintana Roo (including Cancun and the Riviera Maya, which is home to roughly 20 per cent of the entire country's hotel room inventory) and the Baja California peninsula (including Los Cabos, a high-end resort destination that is very popular among investors and visitors from California).

c Real estate developers selling lots, condos, residences, fractionals, vacation plans or timeshare interests under instalment contracts must declare as taxable revenue

28 Mexican Fiscal Code, per text of last reforms approved on 9 December 2103, and in effect from 1 January 2014.

29 Article 2, Value Added Tax Law. Article 2 stated that VAT in border states was 11 per cent. Article 2 was derogated through a Decree on 11 December 2013.

the entire purchase price when the goods or services are sold, regardless of the percentage or amount of the down payment.[30] The provision that allows real estate developers to immediately deduct the entire cost of acquisition of land remains in effect, but it is now subject to the caveat that the developer must start selling real estate (land or a finished product) after the third year, or the deduction is reversed.[31]

d The tax regime that deferred the taxable gain of shareholders that contributed real estate property to real estate investment companies (SIBRAS) has been eliminated; thus, any deferred tax under the regime shall become payable as of 31 December 2016.[32]

e Rules for the application of treaties to avoid double taxation and for repatriating profits via intercompany service and loan agreements between a foreign parent lender or service provider and a Mexican subsidiary borrower or client have been tightened to prevent abusive practices where, for example, a deduction is taken in Mexico on the expense under the agreement, and then no taxes are paid in the parent's home country, resulting in double non-taxation. Likewise, dividends, including those paid to foreign shareholders, are now subject to 10 per cent withholding tax.[33] These inter-company agreements and tax treaty benefits are commonly used by real estate investors in their exit strategies, and they may continue to be used, but now extra care must be employed to ensure proper backup exists in the event of an audit.

iii Anti-Money Laundering Law

In 2013, the Federal Law for the Prevention and Identification of Transactions from Illegal Funds, commonly referred to as the Anti-Money Laundering Law,[34] entered into effect. The Anti-Money Laundering Law seeks to identify clients and users of services related to 'vulnerable' activities (many of which are within the real estate industry), and to obligate service providers to keep information related to their clients and users of vulnerable activity services and, in some specific cases, to report such activities to the authorities.

The following real estate-related activities are considered vulnerable under the Anti-Money Laundering Law:

a loan or mortgage brokering;

b construction or residential development;

c rendering real estate services and brokering real estate transactions;

d buying and selling real estate and entering into leases, timeshare or fractional agreements and other real estate contracts; and

30 Article 9, Transitory, Capital Gains Law.

31 Article 191, Capital Gains Law.

32 The previous capital gains tax foresaw SIBRAS in Article 224-A; however, the new capital gains tax derogates the SIBRAS concept.

33 Article 5, Capital Gains Law.

34 www.diputados.gob.mx/LeyesBiblio/doc/LFPIORPI.doc.

e rendering of independent professional services (such as legal, accounting, consultancy or architectural).

The Anti-Money Laundering Law imposes record-keeping and reporting obligations for each vulnerable activity service provider, depending on the value of the transactions. For example, if a timeshare developer sells a timeshare interest for US$7,900[35] or more, then the developer is obliged to keep the client's personal information. Likewise, the Anti-Money Laundering Law expressly prohibits paying cash for real estate transactions valued at more than US$38,500.

The Anti-Money Laundering Law imposes even more stringent obligations on notaries public and commercial brokers who, in general terms, are obliged to identify and report in greater detail a wide range of obligations that pertain to legal and commercial transactions. Likewise, the construction or development of homes with the intent to sell is also scrutinised, including the brokering of transactions over US$38,000.

In general, to avoid fines, penalties and even criminal liability, real estate developers, brokers and builders are advised to put in place policies and procedures to ensure compliance with the far-reaching effects of Mexico's new Anti-Money Laundering Law.

iv Public-private partnerships (PPPs)

The PPP is a well-known legal instrument available in many countries to promote joint ventures and partnerships between private investors and the public sector for the development of required infrastructure projects that benefit the population.

Mexico's PPP law was enacted in 2012, but was not implemented in fact until 2013. Since NAFTA entered into effect in 1994, Mexico has had well-developed public works and government procurement laws; however, each contracting government agency or state-owned enterprise had their own rules and bureaucracy, which have proved difficult to crack for most foreign suppliers and contractors without a strong local presence. In addition, the supplier or contractor was just that (i.e., one who collects a fee or sells a product), as opposed to a partner that shares in the risk and reward. The new PPP law aims to attract required capital (both domestic and foreign) and proven know-how and, in exchange, enable government agencies and enterprises to offer the upside of a traditional joint venture arrangement, which was not previously available.

Although the focus of the PPP law is on infrastructure and not specific real estate or housing projects, one of the biggest obstacles preventing private sector real estate investment in lesser-developed areas of Mexico has been the unwillingness or inability of the public sector to build the necessary infrastructure (such as roads, bridges, potable water desalination and wastewater treatment plants, and electrification of remote beach areas) to make these new projects viable.

35 Penalties in the Anti-Money Laundering Law are stated in number of daily minimum wages (DMWs) (currently 64.76 pesos).

As a result of the PPP law, 2013 saw an increase in infrastructure investment, which, coupled with the National Development Plan and housing and finance programmes,[36] is expected to pave the way for new commercial and housing projects in future years, and increase the value of both residential and commercial real estate.

v Mexican stock market offers REITs (FIBRAS and CKdes) to attract portfolio investment in the real estate sector

In response to the 2008 real estate and financial crisis and the ensuing lack of traditional sources of capital, the government took several steps to promote economic growth, and in particular real estate and infrastructure development, including the launching of two new securities for trading on the Mexican stock exchange: CKdes[37] and FIBRAS.[38]

CKdes and FIBRAS are modelled on the US REIT structure, and were created to enable investors to access a diversified portfolio of real estate investments via liquid instruments traded on the Mexican stock exchange. They have attracted investors of all sizes and types, both institutional and private, foreign and domestic, and offer, *inter alia*, the following benefits:

a increased private and institutional investment in the real estate capital markets, and hence availability of equity for new projects, given that passive investors now have a liquid, publicly traded certificate;

b more effective and increased access by real estate developers and promoters to capital markets due to the securities' industry-specific nature;

c they attract portfolio investment from foreign REITs and non-industry specific funds looking to diversify into the Mexican capital and real estate markets;

d they have opened the door so that Mexican AFORES (pension funds)[39] can more easily invest in the real estate sector via publicly traded securities; and

e they create vehicles that allow small and medium-sized private portfolio investors to invest in the sector by acquiring a liquid instrument backed by diversified investment with low transactional costs.

CKdes

CKdes are defined under the law as securities instruments for a fixed or fixable term issued by trusts with variable and uncertain returns totally or partially linked to subjacent assets held by the trust, whose purpose is to invest in the development of projects and activities, and to acquire equity interests in other companies.[40]

36 Federal Official Gazette. Regulations for the Financing Programme and Federal Housing Allowance of the 2014 Fiscal Year. 1 July 12013.

37 Federal Official Gazette. Applicable Provisions to Securities Issuing Entities and others of the Stock Market. 22 July 2009.

38 Although the legal framework for Mexican REITs was enacted in 2005 (see Capital Gains Law Reform, published in the Official Gazette, 23 December 2005), legislation was not enacted until 2011 to allow for the creation of FIBRAS traded on the Mexican stock exchange.

39 The AFORES were created to receive, manage and invest, in a secure fashion, funds from individual retirement accounts, and are mandated by Mexico's social security laws.

40 CKdes definition as stated in the Mexican Stock Market Internal Regulations.

CKdes are long-term instruments structured for risk projects such as infrastructure, private real estate development, communications, energy, ports and start-up companies aiming to attract significant capital.

AFORES have proved to be ideal target investors due to their significant amount of available cash (estimated at approximately US$6.5 billion). However, the AFORES have imposed significant requirements on issuers (and lobbied before the regulators), thereby creating delays in the launch of several CKdes.

The securities issued by CKdes are more similar to equity certificates than debt, in that they do not contemplate an obligation to pay principal or interest; nor do they guarantee the return of capital, which return depends on the results of the projects in which the CKdes invests. However, in contrast to shares purchased on the stock exchange, the certificates have a term or due date that varies between 10 and 30 years, depending in the issue.

FIBRAS

FIBRAS are Mexican REITSs.[41] They were created in 2011, and were the first such instruments to be offered in the Latin American stock market. FIBRAS, along with CKDs, have attracted institutional investors such as retirement and pension funds. Total investment in FIBRAS during 2013 amounted to approximately US$4.5 billion, while the combined value of the assets managed equalled close to US$5.5 billion.[42]

FIBRA legal framework

FIBRAs are vehicles for real estate finance. They provide periodic payments (income) and have the possibility of capital gains (added value). Under Articles 223 and 224 of Income Tax Law, they are defined as 'trusts that are dedicated to the acquisition or construction of real property intended for lease or acquisition of the right to receive income from the lease of such property and to provide funding for these purposes'.

Their main difference from other instruments is that FIBRAS must be used exclusively for lease. The Income Tax Law states that a FIBRA must distribute annually at least 95 per cent of its income before taxes, making FIBRAS an investment alternative that is lower in risk than other options.

FIBRAS investors benefit from capital gain property, and they can use resources from the stock market for further acquisitions and to expand their portfolio.

The requirements for a FIBRA are as follows:

a 70 per cent of the assets must be invested in real estate;

b they are to be dedicated to the construction, leasing, purchase and sale of real estate;

c the trust must distribute at least 95 per cent of its taxable income of the previous year;

41 www.bmv.com.mx/wb3/wb/BMV/fibras.

42 www.mexicanbusinessweb.mx/analisis-economico-de-mexico/las-fibras-suman-recursos-por-mas-de-72000-mdp.

d the property must not be sold or transferred within the first four years of the completion of the construction or acquisition of the asset;
e it must be offered through the stock market; and
f it must have at least 10 people (who are not related parties) as investors, with none of these holding more than 20 per cent of the assets.

FIBRAS have offered gains of between 30 per cent to 40 per cent, which, compared with bank or government investments, make them very attractive to the public, as well as for domestic and foreign investment.

To date, FIBRAS have focused mainly on business class hotels, malls and industrial real estate (e.g., FIBRA Hotel, FIBRA Shop and FIBRA Sendero); however, as FIBRAS distribute better income and capital gains to their investors, they are expected to participate and invest in a wider scope of construction and real estate options (e.g., touristic hotels).

FIBRAS benefit all parties in the real estate equation: investors, who now have a way to invest in the Mexican real estate market and obtain good dividends; developers, since new and diverse cash-flow increase opportunities and boost the construction industry; and consumers, who benefit from new and better options in the market.

VIII OUTLOOK AND CONCLUSIONS

Multiple factors point to the continued and sustained growth of all sectors of the Mexican real estate industry in future years. At the macro level, the rebound of the US economy and attractiveness of Mexico compared to the BRIC countries and other emerging markets, due to the strength of its financial and political institutions and geography, will most likely translate into continued higher levels of foreign direct investment in all sectors, including real estate. Likewise, with (1) drug violence decreasing and Mexico's image improving in the eyes of the international press; (2) the approval of CKdes and FIBRAS pending; (3) judicial reform under way; and (4) the recent enactment of structural reforms aimed to increase Mexico's global competiveness pursuant to the Pact for Mexico,[43] the future of all segments of the real estate industry looks bright. In particular, the international tourism and leisure segment and second home market in tourist destinations are again benefiting from the real estate and stock market growth in the US, industrial real estate development is benefiting from Mexico's increased global competiveness, while commercial and urban residential development is being fuelled by increased consumer demand and Mexico's growing middle class.

43 See: http://pactopormexico.org/PACTO-POR-MEXICO-25.pdf. The Pact for Mexico, a far-reaching initiative signed by the leaders of the three main political parties and championed by President Enrique Peña Nieto, has brought about, in less than a year, sweeping constitutional and legislative reforms aimed at breaking Carlos Slim's telecommunications monopoly; overhauling Mexico's education system; rewriting Mexico's Tax Code to close tax loopholes and pursue tax evaders; combating money laundering; and opening up Mexico's energy sector to private investment.

Chapter 23

NETHERLANDS

Annemieke Wessels, Maarten Tinnemans and Max van Drunen[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

In the Netherlands, most real estate law is incorporated in the Civil Code, which contains laws on entitlement to real estate, use, sale and purchase, transfer and encumbrances. The Civil Code follows the old Roman distinction between rights *in rem* and rights *in personam*: rights on property as opposed to personal rights on performance of obligations. In contrast to a personal right, a right on property is absolute as long as it is explicitly recognised as such in the Civil Code; this means that it is enforceable with regard to third parties. The most common absolute rights on real estate are ownership and the limited rights of leasehold, building rights, easements and mortgages (see Section V.iv, *infra*). Common personal rights in respect of real estate are lease, agricultural lease, beneficial ownership and rights derived from a sale and purchase agreement. In general, personal rights cannot be invoked against third parties; however, personal rights can also have absolute characteristics (see Section VI, *infra*).

Ownership is defined as the most comprehensive property right and the most common title to real estate in the Netherlands. Other property rights, such as leasehold and building rights, are derived from ownership. Leasehold allows the leaseholder to hold and use real estate owned by another party. A building right entitles the holder to ownership of buildings or fixtures in, on or above another party's real estate. Leasehold and building rights can be limited in time, use and transferability, and a periodic fee may be payable to the landowner. Ownership, leasehold and building rights can be divided into apartment rights that may be transferred separately or encumbered with limited rights. An apartment right provides its owner with a share in the entitlement to the

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divided property and the sole right of use to the apartment. Housing and multifunctional complexes are often divided into apartment rights. In that case, a community of property exists, and an owners' association with compulsory membership is created.

Dutch law draws a distinction between the purchase and the transfer of ownership of real estate. Purchase is understood to mean the legal basis for the transfer of the property and may be effected by means of a private instrument (or even orally), and is subject to virtually no mandatory provisions. Purchase agreements generally fall under the remit of regulatory law. The transfer of ownership of real estate or the creation of limited rights only takes place, however, once a notarial deed of transfer of title or creation has been signed, and when such a deed has been registered with the Land Registry Office in implementation of the purchase agreement or other title.

ii System of registration

Real estate is registered in the public registers of the Land Registry Office.

The Land Registry Office has a statutory duty to register the geographical location of real estate in the Netherlands and any limited rights created thereon; this also applies to ships, aircraft and networks. The Land Registry Office registers the names and addresses of title holders and stores the documents on which such entitlements are based. Attachments and restrictions under public law (see also Section V, *infra*) are also recorded. The data are accessible to the public and it is also possible to consult them via the Land Registry Office's website.

In cases of transfer of ownership or creation of limited rights, registration of the notarial deed of transfer or creation is required. Such a transfer or creation is complete only once such registration has taken place. In practice, the civil law notary presents the Land Registry Office with an electronic copy of the deed immediately after signature, and it can be seen almost immediately in the registers that a change to the legal status of the property subject to registration in question has taken place. The details of the registration are updated within a few days. In this way, the land registers are kept very well updated.

The civil law notary who has provided the Land Registry Office with the data is responsible for their accuracy. If the data are correct when provided but are processed incorrectly, then the Land Registry Office is in principle liable for any damage resulting from this. If the civil law notary provides incorrect data, then he or she is in principle liable for this.

iii Choice of law

As indicated above, Dutch law states that the purchase of real estate generally falls under the remit of regulatory law. A purchase agreement that applies to real estate located in the Netherlands may also be governed by foreign law; for example, as a result of the choice of another country's law.

The rules of Dutch private international law designate Dutch law as the law applying to the delivery of possession of real estate located in the Netherlands and the creation of limited rights on it.

II OVERVIEW OF REAL ESTATE ACTIVITY

In 2011, €4.8 billion was invested in the Dutch real estate market. Volumes for 2012 were slightly above €4 billion. This fall has been cushioned somewhat by three sizeable transactions in the offices market, including the sale of the High Tech Campus in Eindhoven by Philips to Chalet Group for €425 million in the first quarter of 2012. Volumes for 2013 are estimated at €4.5 billion. A few large transactions in residential real estate occurred, such as the sale of 18 residential complexes by the ASR Dutch Core Residential Fund to Quadrigo with a deal value of €95 million.

Reports in the financial press have ascribed investor reluctance to a lack of financing possibilities, vacant office real estate and a general lack of confidence in the economy; however, demand for real estate investment products remains. In the office market, a large division has emerged between A locations and B locations. There is a fear that outdated office buildings at locations lacking a nearby centre of attraction will no longer find lessees, while demand for office buildings in Amsterdam's Zuidas district has, in contrast, increased. Municipal authorities are attempting to have the intended zoning designations of offices at B locations changed, but transformation is not always possible or desirable.

Institutional investors appear, primarily, to want to expand in retail real estate, especially A locations, and residential real estate. Other institutional and non-institutional investors are increasingly often invited to participate in private funds; recent examples are the ASR Dutch Prime Retail Fund, with a total value of €1.2 billion, and the ASR Dutch Core Residential Fund, with a total value of €0.9 billion. The residential real estate market is also being viewed as a solid investment with acceptable direct returns, although a newly introduced lessor levy is creating uncertainty among investors (see Section VII.ix, *infra*).

III FOREIGN INVESTMENT

Where entitlement to immoveable property is concerned, the law makes no distinction between Dutch and foreign investors. There are no restrictions that apply to foreigners that do not apply to Dutch participants. Similarly, with regard to investment regulations and the tax aspects of real estate transactions, Dutch and foreign actors are in principle treated equally.

Many German parties are active in the Dutch real estate market; Anglo–US investors are also well represented. In recent years, the importance of investors from emerging countries has increased. Islamic investors often make use of shariah financing arrangements.

IV STRUCTURING THE INVESTMENT

A real estate investment can be structured in many different ways. Amendments to the law and regulations regularly result in new structures or in variations on existing structures. Obviously, specific investors' needs are also a factor on a tax, legal, financial and organisational level.

i Companies

The private company with limited liability (BV) and the limited liability company (NV) have legal personality, are incorporated by a notarial deed and have a share capital divided into shares held by one or more shareholders. The shareholders in a BV or NV are not personally liable for acts performed in the name of the company; nor are they liable for contributing to losses of the company in excess of the amount that must be paid up on their shares. Different voting, dividend or liquidation rights between shareholders can be created by the issue of preference shares or separate classes of shares. An Act on simpler and more flexible laws governing BVs came into force on 1 October 2012. The changes introduced by this Act offer greater freedom in structuring BVs. For example, the new law allows the BV's articles of association to limit or exclude certain shares from sharing in the profits. Certain shares may also be excluded from voting. This offers greater flexibility in structuring the relationship among shareholders and provides an alternative to issuing depositary receipts for shares, which is the current option for separating profit-sharing and voting rights.

The main differences between BVs and NVs are:

a the shares in an NV are in bearer or registered form; the shares in a BV are in registered form only; and

b the minimum authorised, issued and paid-up capital of an NV is €45,000; a BV has no minimum capital.

ii Limited partnership (CV)

A CV is an entity without legal personality, entered into by an agreement between one or more general partners and one or more limited partners as money lenders. The general partners act on behalf of the CV and are severally liable for the CV's obligations. The limited partners are only liable for the amount of their capital contributions, pursuant to the partnership agreement. However, if a limited partner acts in the name of the CV or has a decisive influence on the performance of the general partner (or partners), the limited partner becomes severally liable.

Because the CV has no legal personality, its assets are usually owned by the general partners. However, the assets can also be owned by the general partner, or partners, and the limited partners together or by the limited partners jointly. The partnership agreement can provide that a partner may transfer its interest to a third party, subject to such approvals, consents and other requirements as the partnership agreement sets forth. The partnership agreement can be a private instrument and does not have to be in a notarial form. Another benefit of the CV is that it does not have any minimum capital requirements; however, the main reason the limited partnership is a popular investment structure is that it can be established in such a way that it is transparent for Dutch tax purposes. As a result, the CV is not subject to corporate income tax and dividend withholding tax in the Netherlands.

iii Fund for joint account (FGR)

The FGR is often used as an investment vehicle. An FGR does not have legal personality; it is an agreement governing the relationship between the manager, the depositary and an individual investor. This agreement is often referred to as the terms and conditions, and deals with the management and custody of the fund. The terms and conditions often provide that an investor is not liable towards third parties and that its (internal) liability is limited to the amount that it has agreed to contribute.

Dutch civil law does not specifically provide for FGRs. This allows great flexibility in how the terms and conditions are drawn up, and this flexibility makes an FGR a suitable vehicle for real estate investment funds.

For tax purposes, a distinction can be made between a closed FGR and an open FGR. A closed FGR is transparent for tax purposes and is itself not subject to corporate income tax. An open FGR is not transparent for tax purposes and is subject to corporate income tax (at fund level).

An FGR is closed if:

a units in the FGR are transferable only with the consent of all investors; or

b units in the FGR are only transferable to the fund itself by way of redemption without the requirement of the consent of all investors.

iv Cooperative (coop)

The Dutch coop has recently enjoyed considerable popularity as a vehicle for structuring tax-efficient cross-border investments for foreign investors. Subject to limited conditions:

a distributions made by the coop are not subject to dividend withholding tax; and

b no corporate and individual income tax will be levied on the coop's non-Dutch resident members in respect of their membership in the coop.

The coop is an association incorporated by notarial deed. The coop must provide for certain tangible needs of its members, specified in its articles of association. The activities of the coop should have a certain relevance to the activities of the members themselves. This can be the case if a coop invests funds received from members that are themselves also active as investors.

Especially for coops that are part of a group of companies that carry on an enterprise, including groups that are ultimately owned by private equity firms, the Dutch tax authorities are generally willing to confirm in an advance tax ruling that distributions made by the coop are not subject to dividend withholding tax, and no corporate and individual income tax will be levied on the coop's non-Dutch resident members in respect of their membership in the coop.

v Fiscal investment institution (FBI)

The NV/BV, CV and FGR can be structured as an FBI. An FBI is subject to corporate income tax, but at a zero rate. To qualify as an FBI, certain requirements must be met, including restrictions on leverage, shareholders and members of the managing board.

V REAL ESTATE OWNERSHIP

i Planning

An owner's rights to the use of immoveable property are regulated by the Spatial Planning Act and the Environmental Permitting (General Provisions) Act. The zoning plan is a central element in the Spatial Planning Act. This plan is drafted by the municipal authorities and designates the purpose for the land (housing, offices, retail, agricultural use, public space, etc.). In addition, the zoning plan sets out the rules regarding the use of the land and the immoveable property situated on it. Permits concerning the construction of immoveable property can only be issued if the intended use is in keeping with the zoning plan; enforcement measures are available in the event of failure to comply with the prescribed use.

Should a landowner desire to construct immoveable property, convert existing immoveable property or carry out activities harmful to the environment, a permit is required. On the grounds of the Environmental Permitting (General Provisions) Act, effective from 2010, a single permit can be requested that is sufficient for all activities of the landowner's project. This is known as the single environmental permit. A large number of permits, exemptions and notifications (around 25) are integrated into this single environmental permit.

ii Environment

Liability for soil pollution is regulated under the Soil Protection Act. This is based on the polluter pays principle. When it is not or is no longer possible to identify the polluter, the owner is in principle held liable. The owner may also be held liable if the pollution spreads or if others suffer damage as a consequence of exposure to it. The government can force polluters or owners to clean up by ordering them to do so. If this is not possible, the government itself takes on the responsibility for remediation. In summary, the general order of liability is polluter, owner then government.

The strict liability of the owner or leaseholder of a business park reaches further than the strict liability with regard to other properties. The owner or leaseholder of a business park is obliged to clean up after the occurrence of serious soil pollution for which a need of remediation has been established, regardless of whether the pollution was caused by the owner or the leaseholder. The obligation to remediate the soil lies with the owner or leaseholder of the business park in which the source of the pollution is located. For business parks, the polluter pays principle also applies.

iii Tax

Pursuant to the Real Estate Transfer Tax Act, a real estate transfer tax is in principle levied upon acquisition of immoveable property located in the Netherlands. The same applies to rights to which immoveable property is subject, such as leasehold or building rights. The term acquisition includes the acquisition of beneficial ownership. The rate for homes is 2 per cent. The rate for other immoveable property is 6 per cent.

There is a notional provision designating shares in a property entity as immoveable property. As a consequence, the acquisition of shares in a property entity is also subject to real estate transfer tax under certain conditions. Through this legal assumption, the legislature wants to prevent real estate transfer tax avoidance through the transfer of shares in a legal entity that holds immoveable property, instead of a direct transfer by that legal entity of the immoveable property itself. As a result, such acquisitions, which from the legislature's point of view are comparable in an economic sense to ordinary acquisitions, are treated equally in terms of taxation. A property entity is an entity with its capital divided into shares (both with and without legal personality), of which:

a the majority (more than 50 per cent) of the possessions at the time of the acquisition of the shares or at any point in time in the year previous to that time (reference period) consists or has consisted of immoveable property, and at least 30 per cent of the possessions consist or have consisted of immoveable property located in the Netherlands (holding requirement), and

b the immoveable property (taken as a whole) is or was primarily (for 70 per cent or more) of service to the acquisition, disposal or operation of that immoveable property (purpose requirement).

When an interest in a property entity is acquired, a tax levy only takes place if acquisition or expansion of interest constituting at least one-third of the property entity occurs (interest requirement).

The Real Estate Transfer Tax Act contains several exemptions concerning, *inter alia*, an acquisition resulting from merger and divestment, transfers between group companies and the acquisition of networks. Furthermore, an exemption from real estate transfer tax applies to the acquisition of newly constructed immoveable property or building land in respect of which turnover tax is owed.

The delivery of possession of immoveable property is in principle exempt from turnover tax, unless it concerns:

a delivery of possession of new immoveable property taking place before, simultaneously to or a maximum of two years after the date of first occupation; or

b delivery of possession of building land.

Under the law, these forms of delivery of possession have a 21 per cent turnover tax imposed on them.

iv Finance and security

Immoveable property may be encumbered with a mortgage. A mortgage is a limited security interest intended to provide recourse against the immoveable property for a claim for payment of a sum of money, with preference over other lenders. The financing of immoveable property with a mortgage as security interest for the financier is customary with regard to the immoveable property of both private individuals and businesses. A mortgage right is created by a notarial deed recorded in the public registers.

A mortgage right has three important characteristics. First, it is an absolute right that may be invoked against any other party. Should a mortgagor dispose of any immoveable property, the mortgage right on the immoveable property remains. Because the mortgage right is evident from the public registers, there is no room for protection for a third party. Second, the mortgagee has the right to summary execution. If the mortgagor defaults in the settlement of that for which the mortgage serves as guarantee, the mortgagee is entitled to sell the immoveable property. Third, should the mortgagor go into liquidation, the mortgagee is a secured creditor. The mortgagee can exercise its right as though there were no liquidation.

The procedure regarding the foreclosure by the mortgagee contains safeguards to prevent abuse of the right to summary execution and to maximise the proceeds in the interest of the mortgagor and any other lenders. In principle, the foreclosure must take place in the form of a public auction in the presence of a civil law notary. At the request of the mortgagee or the mortgagor and with court approval, a private sale under execution may also be held. At present, a legislative proposal is pending that is intended to make sale under execution of immoveable property possible via the internet. The aim is to make the sale under execution accessible to the wider public and, in so doing, to generate higher execution proceeds.

The mortgage right depends on the claim that the mortgage serves to guarantee. Should this claim be transferred, the acquirer also acquires the security interest pertaining to it. Another consequence of the mortgage right's dependent character is that the right is extinguished once the claim is settled. Bank mortgages are an exception to this rule. A bank mortgage involves the granting of security on all claims that the mortgagee has in respect of the mortgagor either now or at any time and for whatever reason. Therefore, it may only be created prior to the mortgagee's having a claim against the mortgagor.

As well as being created on the debts of the mortgagor, a mortgage may also be created on the debts of third parties. Such cases are referred to as third-party mortgages; the owner and not the borrower is then the mortgagor. Group company financing often involves third-party mortgages. A bank extends a credit facility to the parent company, on the basis of which a mortgage on the immoveable property of the operating companies is provided as security.

Normally, the mortgagee is also the financier. If a banking syndicate performs as financier, it is not practical that all the banks become mortgagees considering the foreclosure process. By means of a parallel debt structure, an agent may be appointed as mortgagee, who the parties agree has an equal claim to those of the combined banks. Such a structure is not contrary to the dependent character of the mortgage right.

VI LEASES OF BUSINESS PREMISES

Tenancy law makes a distinction between two types of business premises: retail premises and other business premises. Lease of retail premises covers, *inter alia*, use of the immoveable property for retail trading, as well as its use as a restaurant, café or craft workshop. The premises must include a space accessible to the public for the direct supply of moveable goods or services. The regime for retail premises is intended to offer protection to the lessee by means of mandatory provisions due to the location specificity of the lessee's business. The other business premises category is a residual one. This regime covers all built immoveable property that is not leased as retail premises or housing. The other business premises category is very broad; for example, it includes offices, parking space, factory buildings, storage space and warehouses. The lessees of other business premises receive only limited protection from the law. In this category, parties have as much freedom in defining the terms of a lease as they see fit.

Business premises leases are customarily drafted in conformity with Real Estate Council of the Netherlands models. These models are the commonly used standard leases for business premises in the Netherlands and are generally lessor-friendly. Among other things, the models concern the term, rent, rent increase, lessee liability and security aspects.

i Retail premises

General leasing regulations apply to the retail premises category. In addition, mandatory provisions apply, including those concerning the lease and notice periods.

The underlying principle of the retail premises regime is that the period of the lease must be at least 10 years. In practice, leases are often concluded for five years with the possibility of extension for an additional five years. Even when no second five-year period is agreed, the lease is extended by five years by operation of law. The underlying idea is that 10 years is sufficient for the investments made by the lessee to be recouped. Should the lease be for a specified period, notice may be given towards the end of that period. Should the lease be for an indefinite period, then notice may be given at any time, provided the duration of the lease has been at least 10 years, and the notice period must be at least one year. Notice given by the lessor terminates the lease only if the lessee agrees to the termination or the lease end date is fixed irrevocably by the court at the petition of the lessor. The lessor can give notice on the following grounds:

a the lessor urgently needs the leased property for its own use (including use as business premises of a different kind or renovation of the leased property that cannot be carried out without termination of the lease);

b the manner in which the lessee operates its business does not befit a good lessee;

c the lessor desires the realisation of the leased property's purpose as designated in a valid zoning plan;

d the lessee does not agree to a reasonable offer to enter into a new lease that does not include any change to the rent; or

e the lessor's interest in termination weighs more heavily than that of the lessee in continuation of the lease.

ii Other business premises

General leasing regulations apply to the other business premises category. Aside from these, considerable contractual freedom exists. No mandatory provisions with regard to lease and notice periods, etc., apply to these types of business premises.

The only mandatory protection the lessee enjoys is that against eviction. Should notice ending the lease be given, notice of eviction must also be given expressly. Should the lessee not agree to the termination of the lease, the lessee's obligation to vacate is suspended by operation of law for two months from the date on which notice of eviction was given. During these two months, the lessee can apply to the court to have the period of suspension extended. Extension by a period of up to one year is possible. The lessee may repeat such an application twice, so that suspension of the obligation to vacate can be extended by a maximum of three years (three times one year). In the assessment of such applications for extension (and in the absence of any misconduct by the lessee), a balancing of interests is made.

There is no possibility of appealing the court's decision on an application for extension. During the period in which the obligation to vacate has been deferred, the rights and obligations of the parties continue to apply. The compensation the lessee must pay to the lessor is in principle the same as the rent that applied on the date that notice of eviction was given; however, should one of the parties so request, the court will fix the compensation that the (former) lessee is to pay during the extension period to come. The court sets that compensation at an amount that is reasonable when compared with other rents in the locality.

VII DEVELOPMENTS IN PRACTICE

i Public-private partnerships (PPPs)

Large and complex infrastructure projects (such as wind farms and motorways) are increasingly often being realised through PPPs. As the commissioning party in this context, the government does not set out in detail the manner in which such projects are to be realised but limits assignment descriptions to their fundamental aspects; the private sector then has considerable freedom in realising the project in its own terms. In this way, the government makes use of the market's capacity to innovate. The most common form of PPP is the DBFM (design, build, finance, maintain) contract. Recently, PPPs have been structured in a way that better facilitates financing by institutional investors.

ii Crisis and Recovery Act

With regard to the current economic situation, the Crisis and Recovery Act entered into effect in 2010. This Act is intended to stimulate the construction sector by accelerating procedures for the realisation of a number of large-scale construction projects. Primarily, this concerns infrastructural works and other projects in the field of home construction, sustainability and water management. The projects are expected to contribute considerably to the economy, employment and accessibility.

iii Reduction of real estate transfer tax on homes

The rate for real estate transfer tax on homes has been reduced to 2 per cent to stimulate the housing market. The rate for other immoveable property is 6 per cent (see also Section V.iii, *supra*).

iv Tax reduction for successive acquisitions

If a property is acquired within six months after the prior transfer, real estate transfer tax is due over the current value minus the value at the prior transfer date. This six-month term has been extended to three years, and applies to the acquisition of properties with a prior transfer date on or after 1 September 2012. This tax measure will stay in effect until 1 January 2015.

v Networks

According to Dutch law, a network of one or more cables or pipes constitutes individual immoveable property. The owner of a network is its authorised constructor or the legal successor. Transfer or encumbrance of a network is only possible following registration thereof in the public registers. Registration of a network is done by means of a notarial register certificate, in which the civil law notary states that the ownership of the network has been demonstrated sufficiently. For this to happen, the civil law notary needs to make enquiries concerning the constructor's authority. In practice, it appears virtually impossible for network companies to prove such authority to construct in relation to some older networks. In such cases, no registration can be made, as a result of which transfer and encumbrance are not possible. To accommodate network owners, transitional legislation came into effect in 2010. On the basis thereof, those who acted as network owners on 1 February 2007 may proceed with the registration of such networks in the public registers, and subsequently with publication of the registration, and finally transfer and encumbrance of the network. Following publication of the registration, an expiry period of one year commences, within which third parties who consider themselves a network's rightful owner may contest the registration at law. This legislation calls for various types of action to secure claims of these very valuable assets.

vi Restructuring

As a result of the current economic situation, a significant increase of work in the field of restructuring has occurred. There is also an increase in disputes relating to breach of contract. Foreign investors have recently shown more interest in real estate portfolios with a value below the amount of the raised loans.

vii Disposition of non-core or redevelopment locations by large and multinational companies

Large and multinational companies are taking a closer look at their real estate. This has led to a number of disposition processes and sale-and-leaseback transactions.

viii Park management

Professional land management in the form of park management is being seen increasingly often in the Netherlands. Due to high land prices and a shortage of opportunities for expansion, the intensive use of space has become a basic principle. Business parks increasingly combine functions to include activities such as sport and dance schools alongside commercial activities. Properly functioning park management is increasingly being seen as necessary for the smooth running of multifunctional premises. In setting up the management of a park, it is generally assumed that optimised park management can only be achieved if it has a foundation in mandatory law. This means that 'free riding' must not be possible and that the legal successors of the various right holders in the business park are bound to the park management's rules. In the Netherlands, a link is generally made here between a property law construction – such as a division in apartment rights (see also Section I, *supra*) or creation of easements – and the membership of a managing legal entity. In this regard, there seems to be a preference for management associations, as these have a consultative structure based in law.

ix Lessor Levy Act

The legislature introduced a levy for lessors who lease more than 10 homes in the controlled rents sector (homes with a net monthly rent up to €681.02 – the applicable amount for 2013). According to the Lessor Levy Act, the lessor must pay a certain percentage over the value of the homes owned in the regulated lease sector. The rate is 0.381 per cent for 2014, 0.449 per cent for 2015, 0.491 per cent for 2016 and 0.536 per cent for 2017. This Act has wide-ranging implications for lessors in the regulated lease sector and has been criticised on several grounds (e.g., financial and administrative consequences for lessors). The estimated tax revenue from the Lessor Levy Act is €1.5 billion in 2017. Lessors can apply for a reduction on the levy if they invest in urgent social purposes, such as transformation from office buildings to residential buildings and demolition of homes in shrinking areas.

VIII OUTLOOK AND CONCLUSIONS

Dutch law regarding immoveable property is stable and characterised by considerable legal certainty. The land registration system is of a high standard and offers transparency regarding the ownership of immoveable property to anyone that is entitled to it under a limited right such as building or leasehold rights, and who has been granted mortgage rights as security. A variety of investment vehicles are available to facilitate joint investment. As a consequence, tax, legal, financial and organisational arrangements can be tailored to any given situation. Tenancy law provides well-balanced rules for two types of business premises. For small, location-specific businesses, the necessary protection is offered, while for the leasing of office premises and factories, parties have considerable freedom to define their mutual relationships as they see fit. Immoveable property in the Netherlands, therefore, constitutes an attractive object of investment for investors striving for a stable investment in the long term.

In the current economic climate, attempts are being made to stimulate the real estate sector through a number of measures including the Crisis and Recovery Act and a reduction of real estate transfer tax on homes, thereby contributing to the economy, employment and accessibility.

Chapter 24

NIGERIA

Gbolahan Elias and Lynda Chinweokwu[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

Nigeria is a federation of 36 states and a Federal Capital Territory. The basic constitutional law position is that land belongs to the respective states in Nigeria, and not to the federation and private citizens; however, land owned by the federal government prior to 1978 and land in the Federal Capital Territory are considered exempt (such land belongs to the federation). Private citizens are in effect no more than lessees of the states and cannot alienate their interests except with the consent of the states.

This means that in practice, sales of land take time (because the 'consent' of the state first has to be obtained), are expensive (because the states give 'consent' only for a fee – in effect, VAT on land) and are fragmented (because land use regulation varies from state to state), and few of the necessary reforms can be imposed on a nationwide (as distinct from state-by-state) basis.

Historically, many states have made grants of certificates of occupancy for up to 99 years. Increasingly, states such as Lagos State (the commercial capital) that used to grant 99-year terms now make grants for no more than 50 years. States that have historically granted terms for no more than 50 years still do not make grants for longer than 50 years.

ii System of registration

There are three registration systems of real estate – registration of title, registration of land instruments and registration of corporate charges. Most states in Nigeria operate the registration of a land instruments system, which was common in old British colonies. The more modern registration of title system has now been adopted in the largest real estate

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markets (Lagos State and the Federal Capital Territory). There are no state guarantees of title under any of the three systems. Title insurance is virtually unknown.

Under a registration of title system, a purchaser may gain priority over unregistered interests created earlier in time but held by persons not in occupation of the land. Under a registration of land instrument system, an instrument that should be registered but is not registered within a given time (typically six months) will not be admissible as evidence in court. It follows that interests that are not created by documents (e.g., leases arising from part performance) may be defeated by purchasers under registration of title systems but cannot be defeated under registration of land instrument systems.

The system of registration of corporate charges is confined to security interests against companies. It does not extend to rights in land generally. Unlike the registration of title and land instrument systems, its focus is on securing priority over creditors in insolvency, rather than protecting purchasers, and it is created by federal rather than state law.

iii Choice of law

Land matters are governed by the real estate laws of the state where land is located, although the Constitution applies nationwide and empowers the federation to regulate aspects of government by giving precedence to certain federal statutes and regulations (notably on tenure and tax on income and capital gains).

II OVERVIEW OF REAL ESTATE ACTIVITY

Average investor returns on equity in many cases exceeded 20 per cent per year in terms of US dollars in the five years before 2008. Prices generally declined between 2008 and 2010 but began to recover in 2011. The lower end of the residential market (in large part because of strength of demand) and the higher end of the commercial market (because of paucity of supply) have been the strongest sectors. Reliable statistics have not been easy to come by, and comments set out here are based very much on our experience, news in the media and anecdotal evidence.

As a result of the financial crisis of the past few years, the real estate market has not been as active as it might have been. Borrowers have defaulted in large numbers, interest rates have risen to protect the currency and lenders have become more risk-averse than ever before. Home mortgages are relatively uncommon, and long-term (over 10 years) home mortgages are largely unknown. Imports of cement, widely believed to constitute 15 to 20 per cent of building costs, were banned for several months to support local cement manufacturers. The price of cement went up, the ban was lifted, but the price of cement has not come down significantly.

III FOREIGN INVESTMENT

i Investment

Foreign pension funds and other foreign institutional and trade investors have been investing in Nigerian real estate. A foreign investor in Nigerian real estate can own the investment on a 100 per cent basis. Foreign investors can invest directly, but only passively, in Nigerian real estate, and to do so they require the consent of the Nigerian state where the real estate is located. In practice, foreign investors in Nigerian real estate invest not directly but indirectly, as shareholders in companies incorporated in Nigeria. Foreign investors do not require the consent of the state to invest in such companies, but it is required for such companies to invest directly in land in the state. An investor planning to do business in Nigeria as an active (not a passive) investor must be incorporated in Nigeria for that purpose.

ii Tax

The corporate income tax rate is 30 per cent. Withholding tax is payable on both rent and dividends at a rate of 10 per cent and is the final tax payable on rent and dividends. If the foreign investor is resident in a country with which Nigeria has a double tax treaty that is in effect (such as the UK, the Netherlands, Belgium and Pakistan), the withholding rate is 7.5 per cent rather than 10 per cent. Further, income tax relief is available, on a sliding scale (from 100 per cent to zero per cent), on lending by foreigners to Nigerians, depending on the tenor of the loan. On loans with a tenor of seven years or more, and having a moratorium of at least two years, the tax relief given is 100 per cent.

IV STRUCTURING THE INVESTMENT

The issues involved in the structuring of investments are tax, limited liability and securities regulation.

The vehicles recognised by Nigerian law for holding real estate investments include limited liability companies (both private and public), partnerships (including limited liability partnerships – Lagos State has a limited liability partnership law) and collective investment schemes with either real estate investment trusts (REITs) or real estate investment companies (REICs). Both such trusts and companies may be open-ended or closed-ended. Both equity and debt investments can be made in these vehicles.

Companies are juristic entities and subject to corporate income tax. Partnerships, whether they have limited liability or not, are not juristic persons and do not pay tax, although each of the partners will be liable to pay tax on its own interest and on distributions made to it. The partners in general partnerships do not enjoy limited liability. Only shareholders in companies and partners in limited liability partnerships enjoy limited liability.

Collective investment schemes for real estate must be registered with and are regulated by the securities regulator. Collective investment schemes must have passive investors and a manager licensed by the regulator, and at least 70 per cent (rising to 80 per cent for some schemes with mortgage assets) of their funds invested in real estate. They are not allowed to invest outside Nigeria, the manager's fees cannot exceed 5 per cent of the net asset value and they cannot borrow amounts greater than 15 per cent of the value of their net assets.

Clearly, collective investment schemes are for professional portfolio managers seeking diversification of assets and large pools of passive investors. Limited liability companies that happen to have substantial real estate holdings do not have to be organised as collective investment schemes; they may be organised as regular limited liability companies. However, distributions to investors in collective investment schemes do not attract income tax. Distributions by conventional limited liability companies do attract tax.

V REAL ESTATE OWNERSHIP

i Planning

The states, not the federation, have the power to make planning laws and regulations for land within their respective territories. Neither plans for areas nor drawings for specific buildings may be implemented except with the approval of state government authorities. These authorities typically have elaborate regulations on the subject and require that only professionals (architects, town planners and engineers) licensed to practise in Nigeria can sign and submit applications for plans and permits.

Planning laws are enforced more stringently than they were 10 years ago. For example, a change in land use now requires the direct authorisation of the Governor in many states, and such authorisation is given sparingly. Twenty years ago, changes of use were, in many respects, in the hands of civil service officials and relatively easier to obtain than they are today.

ii Environment

Virtually every significant development of land requires an environmental impact assessment report that has governmental approval. Both the federation and the states have elaborate rules with similar content on environmental matters. The rules have been adopted from similar laws passed in other English-speaking countries in the latter part of the last century. Nigerian law does not require social and economic impact assessments. However, major real estate developments tend to be financed at least in significant part by those leading foreign banks that require such assessments in view of their commitment to the Equator Principles and comparable internationally accepted standards.

iii Tax

There are diverse taxes on real estate ownership and occupation as well as on the perfection of title to and mortgages over real estate. Many of these taxes are imposed by the states rather than by the federation, and the tax rates vary from state to state. The taxes on ownership and occupation are state taxes and they go by many names. The most common names are tenement rates (usually confined to developed land), land use charges (applying to both developed and undeveloped land) and neighbourhood improvement charges (for designated areas). The perfection taxes imposed at state level include the equivalent of VAT on land (Governor's consent fee) and registration fees. The federal taxes on land include income tax, capital gains taxes and stamp duties. Registration fees calculated at *ad valorem* rates are also chargeable under the federally run registration of land charges system.

iv Finance and security

Real estate is widely used as collateral for loans, although the efficacy of such collateral is limited by delays both in the process of perfecting security and in enforcing secured lenders' rights in the courts (see Section VII, *infra*). Real estate is currently even more attractive as a form of collateral than it was in the recent past. The financial crises of the recent past have led to banking regulations and banking practices that have tended to discourage the widespread use of financial assets as collateral and reduce the availability of cash collateral. By default, real estate has become, perhaps, the most widely used class of collateral.

VI LEASES OF BUSINESS PREMISES

Nigerian law on leases of business premises is basically English common law with some statutory changes to protect tenants. In law, the duration of a lease is limited only by the length of the lessor's title, but leases over 99 years in duration are largely unknown in practice, and most leases of business premises are for 10 years or less. Covenants for insurance, repairs and outgoings, and against lessees assigning, subletting or effecting improvement without the lessors' consent, are used as widely as they are in most foreign real estate markets.

State statutory provisions laying down the notice and other procedures for giving notice to evict tenants must be strictly observed. In some areas there are also rent control regulations, although these have largely been unsuccessful in practice. Most states have laws exempting short leases (typically less than three years) from registration.

VII DEVELOPMENTS IN PRACTICE

Many of the old challenges are still with us. The system continues to improve, but the pace of improvement could increase.

i Registration

Land registration systems are becoming more efficient and the process of perfecting title and mortgages has been getting faster in most states. Land registration and perfection are matters of state, rather than federal, law. In the two areas with the most consistently high land values, Lagos State and the Federal Capital Territory, much of the record-making and record-keeping process is now electronic rather than manual. This has tended to make searches for title quicker and more convenient than they used to be. The trend to make record keeping digital and electronic is likely to become widespread.

ii Tax

Taxes relating to real estate have tended to be high, but the rates have been falling recently. The overall tax burden on a sale of land varies from state to state, but tends to be between 10 per cent and 20 per cent of the value of the land. It used to be between 15 per cent and 30 per cent. Virtually all of the lowering of the tax burden has occurred at the state level. At the federal government level, recent income tax relief has been granted in the form of a seven-year tax holiday for real estate developers on rental income from residential and commercial premises, and on capital gains from real estate. Both the federal income tax relief for interest on residential mortgages and recent the tax holiday of up to seven years for major developments are welcome, but they are not enough. Among other things, stamp duty rates need to fall significantly.

iii Privity

Nigerian law still does not allow positive covenants to run with land except in leasehold contexts. Techniques such as documentation using chains of covenants and attaching compliance conditions to rights to sell land have been widely used, but these and other techniques are not entirely effective. Statutes allowing positive covenants to run with land would make the development and operations of large-scale projects more certain.

iv Litigation

The rule that attempts to sell real estate that is the subject of litigation are void is peculiar to real estate, but still good law. Many users of the court system complain that it works too slowly in most areas of practice, including property cases. The well-known problems remain: the trial courts do not have enough resources, awards of costs against litigants who cause delay are nominal, and piecemeal appeals and other filings made in bad faith are rife. Much work has been done to improve the system, but there is still a very long way to go. For example, several states have now introduced a fast track in civil procedure rules for real estate mortgages, but such rules have had limited success so far. The rules of procedure in states such as Lagos and at the Federal High Court have recently been modified to allow lawsuits to be filed electronically and to make electronic evidence readily admissible and easy to use. This is likely to be convenient for both litigants and lawyers, but it is not obvious that it will make land litigation significantly quicker or shorter than currently obtains.

v A culture of not selling

A culture of being reluctant to sell land is still too prevalent. For family, cultural and other reasons, many landowners prefer to keep significant interests in land rather than give those interests up fully to developers. This is a major challenge for private equity and other institutional investors, as it restricts their freedom at the point of exit to realise their investments at optimal prices.

vi Securities law

The securities industry regulator has promulgated rules for REITs and REICs (see Section IV, *supra*). Few REITs have been established so far, mainly because the federal tax position is still not sufficiently favourable. No REICs have been established yet. Pension funds are empowered by law to invest up to 45 per cent of their portfolios in real estate, but in these uncertain times the holdings of pension funds are dominated by treasury instruments: the yield on treasury instruments has generally been so high that the demand for other fixed-income securities has been limited. A pioneering residential mortgage-backed securities offering was listed in 2012.

VIII OUTLOOK AND CONCLUSIONS

The challenges in Nigeria are many: scarce credit, high cost of materials, heavy tax and tardiness in the perfection and litigation systems. In spite of these, the outlook is good, but it could be better. Much is being done to address the challenges (see Section VII, *supra*). The twin drivers of the real estate market – the growth in the population (some 2 per cent annually) and the growth of the economy (5 to 10 per cent growth in GDP every year) – appear set to keep the real estate market vibrant for the next several years.

Chapter 25

NORWAY

Thorvald Nyquist[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

In 2004, ownership of real estate in Norway changed drastically. Before the change, most income from real estate was taxed at 28 per cent at a company level. From 2004, any gain and most dividends related to shares in limited liability companies was tax exempt for corporate shareholders, resulting in a tax system where the difference between current income, sale of property and interest (taxed at 27 per cent) and income related to ownership of shares (taxed at zero per cent or 0.81 per cent), had a huge impact on the structuring of the real estate market.

Subsequently, nearly all commercial real estate was moved into separate limited liability companies, with each company functioning as a single purpose vehicle (SPV) for the property in question, with such SPVs typically again being owned by a limited liability company in a holding structure.

For these reasons, investments in the Norwegian real estate sector are now carried out through the acquisition of shares of property SPVs, property portfolios consisting of SPVs (in whole or in part) or through professionally managed funds.

Normally, the real estate ownership pertains to both the building and the plot of land upon which the building is standing.[2] However, ownership may be split between the building and the land upon establishment of a ground lease agreement[3] with a duration exceeding 10 years (typically 99 years for commercial real estate).

1 Thorvald Nyquist is a partner at Deloitte Advokatfirma AS.

2 Freehold property, according to UK law.

3 Leasehold property, according to UK law, as regulated by the Norwegian Ground Lease Act of 20 December 1996 No. 106.

Due to historic reasons, some property is also owned separately from the title to the property, with such title being held elsewhere in the corporate structure.

ii System of registration

Norwegian properties are registered in a land register maintained and operated by the Norwegian Mapping Authority, which is the judicial authority for properties in Norway. The land register is the official register of legal rights and obligations associated with fixed property and housing cooperatives. The land register lists ownership in addition to rights and encumbrances such as mortgages, leasing rights and pre-emptive purchasing rights. Details of the physical aspects relating to a property, such as borders, areas, buildings and addresses, are registered in the new cadastre property register, which is maintained by the individual municipalities.[4]

Failure to register ownership of the property, rights, encumbrances, etc., does not alter the underlying legal situation between the original contractual parties. However, a third party may in good faith extinguish all rights, including ownership rights that are not registered prior to the time of the colliding right of the third party.

Registration of a transfer of title in the land register is therefore the only way to obtain legal protection against third parties. No notary public is involved during the registration process.

The Norwegian authorities do not hold a similar register for the purchase of shares. Even though the books of the company shareholders must always be updated according to ownership changes, there are no public disclosure obligations on the company or the shareholders themselves.[5] This may make uncovering the ultimate identity of the property owner difficult.

iii Choice of law

The purchase of shares of property SPVs is regulated by the Norwegian Sale of Goods Act,[6] while the purchase of the property is regulated by the Norwegian Alienation Act.[7] This duality has raised certain questions in the past regarding the buyer's right to claim damages for defects in the property when the formal object of purchase has been shares. The Alienation Act is also fairly consumer oriented; thus, a commercial real estate transaction will normally be regulated by a customised standard agreement to cover both the aforementioned duality and the professional business aspects of the transaction.

The two standards prevailing today are issued by the Norwegian Business Real Estate Brokers Association et al. and Gyldendal Rettsdata respectively; the former is considered to be slightly more lenient towards the interests of the seller than the latter.

4 The municipality is the lowest level of local authority. As per 2013, there were 428 municipalities in Norway within 19 counties.

5 However, information about the ownership of shares in Norwegian public limited liability companies is available through the Norwegian Electronic Securities Register.

6 Norwegian Sale of Goods Act of 13 May 1988 No. 27.

7 Norwegian Alienation Act of 3 July 1992 No. 93.

II OVERVIEW OF REAL ESTATE ACTIVITY

As per Q3 2013, the Norwegian business real estate transaction market had seen over 100 transactions (exceeding 50 million Norwegian kroner) with a total transaction volume of 30 billion Norwegian kroner. After several years of the tightening of finance availability, the past few months have shown an improvement in the debt financing situation for low-risk, capital-intensive projects, but remains a challenge for housing developers. It is generally considered that the largest net buyers of commercial real estate will remain professional property companies as well as syndicates and funds, while Norwegian funds, life insurance companies and property users will be net sellers.[8] In addition, there has been a large number of transactions with a property value of below 50 million Norwegian kroner.

Over the past year, one in four sales had a net yield of 6 per cent or less, fewer than 10 per cent of sales had a yield of over 8 per cent, and the OBX Real Estate Index showed growth of 8.31 per cent.[9]

At the monetary policy meeting in December, Norges Bank left its key policy rate unchanged at 1.5 per cent. The new projection is now a hold on the rate until 2015, when it is expected to gradually increase.[10] Norges Bank has underlined that growth prospects for the Norwegian economy have, to a certain extent, weakened. House prices have somewhat declined recently, while household debt growth remains high. Unemployment is still low, but wage growth may be somewhat lower going ahead than was earlier projected. At the same time, the krone is weaker than assumed. Consumer price inflation is also projected to be rather lower than previously projected.

At the same time, demands for housing are sharply increasing in central areas, and particularly in the largest cities, indicating that correct timing in the private housing construction market will be key in the future.

III FOREIGN INVESTMENT

All acquisition of real estate ownership rights as well as right of usage are conditioned upon the applicable concession from the authorities.

However, there are no practical limitations on foreign investment in and ownership of Norwegian real estate, except for farmland, and some important exceptions within the industry and energy sectors (waterfalls, etc.).[11]

The most important acts limiting acquisition and ownership of real estate are the Norwegian Concession Act[12] and the Act on Acquisition of Waterfalls, Mines and

8 UNION Market Report Autumn/Q3 2013, available at www.union.no.

9 OSE4040, as of 8 December 2013.

10 www.norges-bank.no/no/om/publisert/pressemeldinger/2013/pressemelding-5-desember-2013.

11 In accordance with the EEA Agreement, Annex XII, Norway adopted the free movement of capital effective from 1 January 1995, and all previous legal limitations on foreign ownership were cancelled.

12 Norwegian Concession Act of 28 November 2003 No. 98.

other real estate.[13] In effect, the Norwegian Competition Act will also limit acquisitions of companies in possible violation of Norwegian and EU competition and antitrust legislation.

A concession is generally not necessary for the acquisition of SPVs that have already obtained a concession; direct acquisitions of developed property when the plot of land is no larger than 100,000 square metres; or acquisitions of undeveloped land for the construction of a permanent residence or holiday home on plots of land no larger than 2,000 square metres. The purchaser must, however, obtain a confirmation by the municipality to document the fact that a purchase is concession free. Some concessions are also granted under certain conditions, for example, farmland where the acquirer normally must inhabit and operate the acquired land.

IV STRUCTURING THE INVESTMENT

Real estate may be held directly by domestic or foreign persons; however, real estate investments in Norway are normally made through domestic or foreign companies.

The general taxation on income or gains derived from real estate is 27 per cent from 1 January 2014; however, due to special regulations in the current tax regime, most gains will be tax exempt for investors. Current income derived from real estate investments (such as rent) will always be taxed at a rate of 27 per cent on the recipient. Subsequent taxation of the income will depend on the method of distribution up the ownership chain, and normally will be covered by the tax-exempt regime, as described below.

Income on interest will always be taxable at a rate of 27 per cent at every level in an investment structure and, due to a new regulation that will restrict deductions for net internal interest within a corporate group as of 1 January 2014, all larger debt-based investments with internal loans or cross securities are recommended to seek advice on the outcome of these rules before implementing the investment structure in Norway.

The normal Norwegian limited liability company (an AS) has a requirement of a minimum share capital of 30,000 Norwegian kroner, which is a recent change in the previous requirement of a minimum share capital of 100,000 Norwegian kroner. A Norwegian public limited liability company (an ASA) has a requirement of a minimum share capital of 1 million Norwegian kroner, and is the compulsory form if the shares are to be listed on the stock exchange. For other purposes, the company regulations are mainly similar, and both will provide limited liability for shareholders. Further, there are no general limitations on foreign ownership.

On a general basis, any income in the company is subject to general income tax at a rate of 27 per cent, and any distributions or gains to personal shareowners are taxed at a rate of 27 per cent; thus, the overall tax burden is 46.71 per cent.

However, to prevent chain taxation, any gains, losses or dividends related to shares will be tax-exempted under the current Norwegian Tax Exemption Method.[14] A

13 Act on Acquisition of Waterfalls, Mines and Other Real Estate of 14 December 1914 No. 16.

14 Norwegian Tax Act Article 2-38.

tax group is formed where a company shareholder holds at least 90 per cent ownership (and voting rights) in the underlying company. As a result, within the tax group there is no taxation between each company level on gains and dividends. Outside of the tax group, there is taxation on 3 per cent of any dividends for each company level, resulting in chain taxation for dividends but not for gains.

As a consequence of the Norwegian Tax Exemption Method on the sale of shares, it is reasonable to hold real estate in SPVs, normally through holding each property in a separate AS as an SPV. This structure will allow for the sale of the property through the sale of shares in the SPV if the property has risen in value, resulting in a tax-free gain. On the other hand, one may opt to sell the property directly in the event of a decline in value of the property, and thus be entitled to a tax deduction for such loss. Therefore, if the investment is structured correctly, the tax rules are asymmetrical in favour of the taxpayer. The current tax rules result in real estate investments in Norway being especially attractive for tax purposes.

Depending on the jurisdiction of the shareholder, there may also be withholding tax on distributions to foreign investors or entities outside the EU and the EEA. The normal rate is 25 per cent, but depending on the tax treaty between Norway and the jurisdiction of the foreign investor, the rate may be reduced to between 5 per cent and 15 per cent for some jurisdictions.

To ensure that the investment is structured correctly, it is advisable to plan the structure in advance of any acquisition of real estate, and thus set up the framework for the investment before acquiring the property. In any case, it is possible to structure the acquisition afterwards through, for example, mergers, demergers or a transfer of assets within the tax group. Such reorganisations may be done with tax continuity for both the investment company and the shareholders, but will in most cases be considerably more expensive and complicated than setting up the structure correctly from the start.

V REAL ESTATE OWNERSHIP

i Planning

The Norwegian Planning and Building Act[15] contains rather detailed regulations related to planning on the national, regional and local levels; requirements for dispensation and exemption applications; regulations related to responsibility, control and supervision during the construction phase; and the main requirements during the completion and approval phase.

In addition, the Act also regulates the landowners' general right to compensation due to the compulsory acquisition by the authorities for planning purposes or by direct claim of public ownership (expropriation).

Planning is organised as a top down system, so that no plan at a lower (more local) level may be in conflict with plans higher in the hierarchy. Planning is generally a continuous and sector-dependent process at all governmental levels.

15 Norwegian Planning and Building Act of 27 June 2008 No. 71.

As an example, an upcoming revision of the national transport plan may influence regional zone planning, which again may have consequences for the approval or refusal of local construction projects that appear to be in line with current plans. A plan may also be objected against by any party directly affected by said plan, as well as being subject to overriding sector-specific public concerns. Thus, ratifying plans tends to be a lengthy and complex affair.

ii Environment

Environmental considerations have occupied a considerably larger place in Norwegian legislation over the past few decades, and are particularly visible in the planning and approval stages of property development projects. Environmental warranties have also found their way into most business real estate transactions.

The Norwegian Pollution Act[16] stipulates that the main responsibility for pollution damage rests on anyone that 'operates, uses or holds' any real estate, object, plant or business without regard to *culpa*. As a starting point, this would normally be the owner. In cases where the owner and the operator of the property are not the same, the owner may be jointly liable with the operator (as the polluter) (e.g., if such owner is liable according to the Norwegian Neighbour Act).

Pollution liability in Norway is built upon the international polluter pays principle. This means that the polluter shall not only cover all reparative and preventive costs, but also the social costs that such pollution results in for society.

iii Stamp duty/VAT

Registration of a change of ownership to a property by the Norwegian Mapping Authority is subject to 2.5 per cent stamp duty based on the market value of the property. This does not apply to the sale of companies that own the property, as the direct ownership of the property itself does not formally change. Exceptions are also made for newly built properties, where the 2.5 per cent stamp duty applies only to the appropriate ground value until one year after the completion of the building.

The sale of real property or shares is not subject to VAT. This implies that input VAT on building costs is not deductible when the purpose is to transfer the property after completion. However, some exceptions exist where the property is built with the purpose of letting out.

iv Finance and security

Properties may be encumbered with mortgages as well as other types of securities, based on a first come, first served principle with no upper limit. Properties are generally also considered as stable collateral for other financial purposes, and are therefore widely used for financing bank loans and similar.

Even though there is a general prohibition against using the shares or other assets in a target company as security for a loan that enables the acquisition of such target

16 Norwegian Pollution Act of 13 March 1981 No. 6.

company, there is a narrow exemption with regards to using the property as security in SPV transactions.

As with the protection of the title to the property, unregistered loans or other types of agreed securities will not have any effect against third parties that have registered their security in good faith prior to the unregistered security.

Two other common forms of securities are the *urådighetserklæring* and the *sikringspant*. The first, which can be loosely translated as a declaration of non-disposal, is a catch-all encumbrance that prohibits anyone deleting or registering any security, mortgage or lien without the written approval of the right holder. The latter is a normal mortgage, but with the sole function of securing any and all liabilities that may arise during the course of a transaction.

VI LEASES OF BUSINESS PREMISES

Based on the prevailing Norwegian lease standards, the three most ordinary contract types regarding leases of business premises are as follows:

a As is: the tenant rents the business premises as they are presented at the time of the contract or takeover, and accepts all non-material defects. The tenant will be responsible for indoor maintenance, whereas the lessor assumes responsibility for the maintenance of the exterior of the building as well as the replacement of technical installations (lifts, air conditioning systems, etc.). The lessor must accept normal wear and tear during the lease period (i.e., the general deterioration of the lease object due to normal usage by the tenant). Thus, the tenant is only responsible for lack of maintenance and any damage caused to the lease object that arises during the lease term. The lessor will maintain the common areas, such maintenance being a part of the joint costs paid by all tenants.

b As built/as new: the tenant rents business premises that are new and often built to the particular specifications of the tenant. All defects or deviations from the specification are subject to complaint by the tenant; in all other ways, as above.

c Barehouse: as above, but the lessor rents the entire building structure and will thus assume the entire responsibility of the building, including insurance, all maintenance and replacements.

The typical commercial lease term will be for a fixed period of between of five and 10 years; however, certain commercial property is also rented out on a short or mid-term basis (one to three years, and three to seven years, respectively). In many cases, long-term agreements have an option for the tenant to extend the lease, normally for no longer than 10 years (five plus five years), under the same legal terms and conditions but at a renegotiated price (at the market level) for each prolongation term.

Lease agreements may be terminable or non-terminable during the fixed lease period; they may also be agreed to have an undefined term, but typically with a requirement of six to 12 months' prior notice of termination.

Rent is normally agreed as a fixed sum per square metre per year, exclusive of the proportional part of the joint costs of the property and applicable VAT.

The tenant must also pay any and all costs that relate to own usage of power, insurance of its own business, normal indoors maintenance and repairs. In 'as is' and 'as new' leases, the lessor will insure the building and replace all technical installations when maintenance is no longer remunerative. The tenant must normally accept all actions by the lessor that are necessary for the maintenance and renewal during the lease period. If such actions affect the lease materially, the tenant may claim damages or a discount on the lease, the latter normally being capped at the amount of three to six months' lease.

Prior to the commencement of the lease, the tenant must normally deposit into a deposit account, or issue a bank guarantee equal to, three to 12 months' rent as security for any unpaid rent or other claims the lessor may have against the tenant.

The rent is typically adjusted yearly according with the general consumer price index, although sometimes other indexes are used. The parties will often agree that the rent may not be reduced. The tenant may not hold back or offset his or her rent obligations against claims he or she has against the lessor. If such claims are not honoured by the lessor, the tenant must therefore take out separate legal proceedings to have his or her claim covered.

Subletting and transfer rights are normally require the prior written approval of the lessor, subject either to reasonable cause or without reason. However, the tenant may normally transfer the agreement, or sublet within a structure of companies, as long as the guarantee is upheld.

The leasing of real property is exempt without credit for VAT purposes. It is, however, possible to opt for a voluntary registration for VAT purposes for the leasing of real property to taxable businesses. Consequently, it is not possible to opt for a VAT registration when renting to tenants that only carry on business that falls outside the scope of the VAT acts (governmental bodies, health-care and financial institutions, etc.).

A consequence of voluntary registration is that the landlord may deduct input VAT on the building costs, maintenance, etc., and at the same time invoice the rent and other supplies with VAT.

The VAT adjustment scheme applies for input VAT on the building costs (capital expenditure) of real property. The adjustment period is 10 years, implying that the real property must be used in taxable business for this period in order to avoid repayment of deducted VAT.

VII DEVELOPMENTS IN PRACTICE

With some exceptions, the Norwegian property market has had a fairly stable legislative regulation in the past. There are no major proposals (i.e., White Papers) for alterations to the legal framework that are expected to change the market in any significant way, even though there has been discussion about altering Norway's farmland legislation to pave the way for green land projects in the wake of the recent change from a social democratic left wing/centre based government to a liberal-conservative right wing government.

For commercial property, the importance of taxation and VAT issues has escalated in the past decade, and these issues are now crucial factors to be taken into consideration in all real estate-related business.

There have been many significant VAT and taxation changes during the past decade, beginning in 2004 with the introduction of the participation exemption method, which, as discussed above, has resulted in most commercial property being held by SPVs that are the subject of transactions.

Tax-wise, the national budget for 2014 has introduced limitations on deductibility on interest in group loans. These regulations are expected to influence financial models for property acquisitions in the higher price ranges exceeding 100 million Norwegian kroner.

Property lease is not subject to VAT; however, businesses and public enterprises that let buildings or hire plants are permitted to voluntarily register in the VAT register when the premises are used for VAT-liable business. As the deduction of VAT at a rate of 25 per cent is critically important for developers, the introduction of regulations for the adjustment or reversal of input VAT in 2008 have become driving parameters for development and lease projects.

In 2012, the European Court of Human Rights decided that the Norwegian Ground Lease Act was partly in conflict with the European Convention of Human Rights. This has resulted in changes in the Act's regulation of prolonging ground lease contracts. The changes are expected to enter into effect in July 2014 but will have no significant effect on the professional business market.

The technical requirements for constructing private homes and apartments have become stricter and more costly over the past few years due to new energy and environmental requirements. Combined with increased cash requirements prior to taking up house loans, these have generally led to a slower and tougher market for housing constructors. It is believed that the government must ease both the financial and technical requirements in order to meet Norway's upcoming housing demands, although at the moment, no particular government actions are known of in this regard.

VIII OUTLOOK AND CONCLUSIONS

After a downturn in the wake of the 2008 credit crunch, the Norwegian real estate sector has shown gradual, steady improvement and is now considered to be on its way to full recovery.

The Norwegian economy has also shown gradual, moderate improvement since 2010. This, together with a projected 1 per cent growth in employment and strong population growth, suggests an increasing need for growth areas in Norway (typically in central Oslo, Stavanger and Bergen), and a stable, or perhaps slightly declining, market in rural areas.

We have also seen a series of international investors taking an interest in the Norwegian market, suggesting that blue chip properties will be priced at lower yields in the future.

Taking all factors into consideration, we expect the Norwegian real estate market to continue to present interesting investment opportunities. A gradual liberalisation is expected in the construction sector, especially on entry level apartments and similar projects, and thus would appear to present the most interesting business opportunities once the government recognises that the current technical requirements, as well as financial requirements on banks lending to first-time buyers, over time have become too strict.

Chapter 26

POLAND

Agata Demuth and Michał Gruca[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

The two most common forms for holding real estate as an owner are ownership and perpetual usufruct. Both rights are regulated by the Polish Civil Code.

The perpetual usufruct right is a quasi-ownership right limited by reference to time and purpose. The perpetual usufruct may be established only on real estate owned by the State Treasury or a municipality. The agreement on the perpetual usufruct right establishment may impose specific limitations as to the purpose for which the real estate is used. The perpetual usufruct is limited in time, and is usually valid for 99 years. In exceptional cases, when the economic aim of perpetual usufruct does not require handing over the land for a period of 99 years, such period may be shorter, but must be at least 40 years. The right is renewable, that is to say, within the five years prior to the lapse of the perpetual usufruct term, a perpetual usufructuary may request that such period be prolonged for another 40 to 99 years. As opposed to the perpetual usufruct, the ownership right is unlimited in time. A perpetual usufructuary must pay an annual fee (between 0.3 per cent and 3 per cent of the current market value of the land), whereas in the case of ownership, no such fee is required. Some provisions relating to the ownership right also apply to perpetual usufruct; for example, provisions on the transfer of real estate ownership apply to the transfer of real estate perpetual usufruct rights.

Generally, all real estate is registered in the land and mortgage registers held by the district court competent for its location. Land and mortgage registers are accessible by the general public (this does not apply to the registers' files, which generally are accessible only by the real estate owners and perpetual usufructuaries, and persons authorised by them).

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Entries in the land and mortgage registers are made upon application, unless a specific provision provides for making an entry *ex officio*. The owner of real estate must file an application to show its rights in a land and mortgage register. Failure to fulfil this obligation results in the liability towards a third party for damage caused by the non-fulfilment or delay in the fulfilment of this obligation.

As a general rule, entry into the land and mortgage register does not create a right (i.e., it is not constitutive). In most cases it is declaratory and confirms a right that already exists. There are a few exceptions to this general rule in cases where an entry creates a given right or makes its transfer effective (constitutive entries); for example, an entry of a separate ownership of premises in multi-premises buildings is necessary to create this right, an entry of the perpetual usufruct right is obligatory for establishment or transfer thereof, and an entry of a mortgage is necessary for its establishment.

In the event of a discrepancy between the land and mortgage register and the actual legal status, the law favours the person who by a legal act with a person authorised in accordance with the land and mortgage register has acquired the ownership or other property right (principle of reliability of the land and mortgage registers). The principle of reliability of the land and mortgage registers does not protect free of charge transactions or transactions made in favour of an acquirer that acts in bad faith. A person acting in bad faith is one who knows that there is a discrepancy between the land and mortgage register and the actual legal situation, or a person who would have easily learned about such discrepancy.

Generally, parties are free to choose the law governing their real estate transactions. However, Polish law is mandatory with respect to ownership and other rights *in rem* concerning real estate located in Poland.

II OVERVIEW OF REAL ESTATE ACTIVITY

The somewhat slower activity of investors in the real estate market during recent years has resulted from the overall economic slowdown in the EU. However, the Polish economy continues to perform well. The positive short-term and long-term prospects of the Polish market, and more specifically the centrally located Warsaw market, are helping to keep the local market afloat. The short-term prospects result largely from migration trends, with the movement of the younger elements of the population to the cities, and from the steady inflow of (mostly foreign) industrial and service investments. These positive factors are, however, being tested by the limitation of credit due to the global economic crisis, and the stringent criteria for credit imposed by the Polish banking supervision authority.

2012 and 2013 have been among Poland's best years in terms of total commercial real estate investment volume. The largest part of the investment volume was connected to the office sector; the retail, industry and warehouses sectors were a bit weaker. Warsaw remained the largest office and retail market, although investors' interest in other major cities is increasing.

III FOREIGN INVESTMENT

Under the Act on the Acquisition of Real Estate by Foreigners, a foreigner must obtain a permit to acquire real estate in Poland. Permits are issued by the Minister of Interior provided that the Minister of National Defence does not raise any objection and, in the case of agricultural and forest real estate, in addition provided that the Minister of Rural Development does not object. Moreover, in some cases a permit is also needed for the indirect acquisition of real estate (i.e., for acquisition of shares in a company that is an owner or perpetual usufructuary of real estate).

For the purposes of the aforementioned law, a foreigner is:

a a natural person who is not a Polish citizen;

b a legal person that has its seat abroad;

c a partnership without legal personality of the entities mentioned in points (a) and (b) above that has its seat abroad and was established under the law of a foreign state; or

d a legal person and a commercial company without legal personality that has its seat in Poland, controlled directly or indirectly by the entities mentioned in points (a), (b) and (c) above.

Since 1 May 2004, the general rule that foreigners must obtain a permit to acquire real estate or shares in companies that are real estate owners or perpetual usufructuaries, or both, does not apply to citizens or commercial companies whose place of residence or registered office is in the European Economic Area or Switzerland. However, this exemption will not apply to the acquisition of agricultural or forest real estate until 2 May 2016.

IV STRUCTURING THE INVESTMENT

Commercial real estate projects are structured either as straightforward asset deals or as share deals with separate special purpose vehicles.

The suitability of particular structures for real estate investments will largely depend on their tax attractiveness for the intended investors, as well as on the costs and ease of operating the holding structure. As an additional factor, the regulatory limits on the types and origin of investments that bind some types of domestic institutional investors, in particular pension funds, may play a role in structuring the investment.

Currently, the two most common special purpose vehicles structures on the Polish market are limited liability companies and partnerships limited by shares. Due to recent changes in the Polish tax legislation that impose corporate income tax at the partnership level as of 1 January 2014, partnerships limited by shares have been successively replaced with limited partnerships that are not subject to this corporate income tax.

i Limited liability companies

Limited liability companies are attractive and easy-to-operate investment structures, especially common among foreign funds and other investors who are not bound by special regulatory restrictions determining the desired form of investment. A Polish limited liability company will be liable to pay corporate income tax; however, the overall tax burden will largely depend on the holding structure. Moreover, limited liability companies may not be the most attractive and effective structures for some types of investor.

In its basic form, a limited liability company must have a management board consisting of at least one board member. It is possible for one investor to hold all the shares in a limited liability company.

ii Limited partnerships

A limited partnership is not a legal entity in the full sense, but it may acquire property, including real estate, in its own name. A limited partnership must have at least one general partner who is liable for the debts of the partnership without any limitation, and at least one limited partner. It is common for a limited liability company to become a general partner in a limited partnership.

From a corporate income tax perspective, the limited partnership is transparent (i.e., there is no taxation at the partnership level) and the tax is paid only at the level of the partners.

Despite the relatively complicated structure and high costs, the above investment scheme is very attractive for investors. The costs of the structure are outweighed by the tax benefits – especially in the case of larger investments – and the availability of the scheme to institutions makes it an interesting option for structuring real estate investments.

V REAL ESTATE OWNERSHIP

i Planning

The Spatial Planning and Zoning Act and the Construction Law set out basic rules for local development and facilities construction.

Each municipality adopts its own local zoning plan (master plan) setting forth conditions of local development within that particular municipality. If there is no master plan (which is likely, as the majority of the Polish territory has not yet been covered by master plans), it is necessary to obtain a zoning decision (a Wz decision) before applying for a building permit. The Wz decision sets our major conditions for a particular plot development.

The Construction Law lists all the cases where a building permit is not required; in all other cases, a building permit must be obtained. If a building permit is not required, the investor should notify the local authorities that he or she is to commence construction works and, provided that no objection is raised within 21 days, he or she will be allowed to do so. Whenever a building permit is needed, the construction works may not be started before the permit is issued and becomes final and binding.

The Construction Law also lists all the cases where an occupancy permit is required; in all other cases, the investor should notify the local authorities that the construction works are completed and that the facilities are ready for use. Provided that no objection is raised within 21 days, he or she is allowed to commence their usage. The necessity of obtaining an occupancy permit may also be imposed on the investor in the building permit. In most cases where a building permit is required, the facilities may be only used upon a notification.

ii Environment

There is a specific regime for liability related to environmental damage of land, which greatly depends on the date when the damage occurred.

If the damage occurred before 30 April 2007, the obligation of land reclamation rested with the holder of the land. An exception to this rule referred to cases where the landholder proved that ground contamination or an unfavourable change of the natural land formation, made after the holder took possession of that area, was caused by another entity. In such case, the perpetrator of the damage was then obliged to reclaim the land. Landholders could protect themselves against liability for environmental pollution caused before 1 October 2001 by reporting this fact to the Province Chief Administrator by 30 June 2004. In such case, the holder of an area was freed from liability.

Liability for environmental damage that occurred after 30 April 2007 has been regulated differently; the liability for such damage rests with the entity taking advantage of the environment (perpetrator). However, the landholder (owner or perpetual usufructuary) must jointly and severally reclaim the land together with the perpetrator if the environmental damage occurred with the consent or knowledge of the holder. Such liability may be avoided if the holder immediately notifies the environmental damage to the Environmental Protection Authority. Should such notification not be made, the holder will also be held liable.

iii Tax

Sale of real estate is generally subject to value added tax. However, in certain cases (i.e., supply of land that is not for development, buildings and constructions) the sale of real estate will be subject to tax on civil transactions at a rate of 2 per cent of the market value of the real estate being sold.

Sale of a real estate enterprise (i.e., business as a going concern) is subject to tax on civil transactions, usually at an effective rate of 2 per cent of the market value of the business's assets.

All real estate transfer (sale, exchange, contribution in-kind, etc.) agreements must be executed in the form of notarial deeds to be valid. The parties to such deeds are obliged to pay the notarial fee, which is calculated *pro rata* on the real estate value. Regardless the real estate value, the maximum fee cannot be higher than 10,000 zlotys.

iv Finance and security

Mortgage is the most common form of security. It secures a monetary receivable or several receivables of the same creditor, or several receivables of various creditors provided that they credit the same investment, up to an indicated maximum amount.

Any agreement (or one party declaration) on the mortgage establishment must be executed in the form of a notarial deed and entered in the land and mortgage register to be valid and effective (constitutive entry). This does not apply to mortgages established in favour of banks having their seats in Poland, where a written statement issued in line with the Bank Law will be sufficient to enter the mortgage in the land and mortgage register.

Since the Law on Land and Mortgage Registers and Mortgages was extensively changed in 2009 (effective as of 20 February 2011), one should check exactly when the mortgage was established to verify its validity and effectiveness and apply the proper law provisions.

VI LEASES OF BUSINESS PREMISES

The lease of commercial premises is regulated by the Civil Code. Most of the Civil Code's provisions may be changed by the parties in the lease agreement.

Leases may be concluded for a definite or indefinite term. A lease agreement between entrepreneurs (i.e., natural persons conducting business activity or commercial companies) (commercial lease) for over 30 years is deemed, after this period, to be for an indefinite period. For a lease not between entrepreneurs, after 10 years the lease is deemed to be for an indefinite period.

In the case of leases executed for indefinite periods, both the lessor and the lessee may give notice of termination in accordance with the statutory notice period, the length of which depends on the intervals of rent payment adopted by the parties. If the lease is executed for a definite period, both the lessor and lessee may give notice of termination only in the circumstances set out in the agreement, which may be defined very broadly.

Generally, the parties are free to agree on the amount of rent payable. The rent may be in the form of money or other consideration. Rents are usually paid monthly in advance. If the lessee is in default for no longer than a year, the lessor is entitled to a statutory pledge on the lessee's moveables on the property, unless these moveables are not subject to seizure. If the lessee has fallen into arrears with rent payments for at least two full payment periods, the lessor may give notice of termination without observing the notice period.

It is common practice to apply an indexation clause, under which the rent amount depends on the change in external indices referred to in the agreement. As there is no list of indices as a point of reference for indexation under Polish law, the parties may set these using their own discretion. Currently, the most common rent indexation mechanisms are based on indices for increases in consumer prices in foreign countries or in Poland, depending on the currency in which the rent is established.

Under the Civil Code, the lessor should hand over the premises to the lessee in a state that is fit for use, and maintain it in this state during the validity of the agreement. The lessee bears minor outlays connected with ordinary wear and tear. If, during the validity of the agreement, repairs are required without which the premises would be unfit for use as referred to in the agreement, the lessee may set the lessor an appropriate period in which to carry out the repairs. If this proves ineffective, the lessee may carry out necessary repairs at the lessor's cost.

If the object of the lease has defects that restrict its usefulness compared with the contractual designation, the lessee may demand an appropriate reduction of the rent for the period in which the defects existed. If, at the time the object was handed over, it had defects that prevented the use designated in the agreement, or if the defects occurred at a later date and the lessor, despite being notified, failed to remove them within an appropriate period, or if they prove impossible to remove, the lessee may terminate the lease without a notice period. In practice, however, in commercial lease agreements usually the lessee must carry out maintenance, and must bear the majority of repair and maintenance costs.

As a rule, at the moment the lease agreement is executed, the lessee is obliged to provide the lessor with security for any potential claims, particularly relating to rent. The most common forms are cash deposits, bank guarantees, corporate guarantees and voluntary submissions to the enforcement proceedings.

Unless otherwise agreed, the lessee may not hand over the whole or part of the object to a third party for use free of charge or as a sublet without the consent of the lessor. If the object is handed over to a third party, both the lessee and the third party are liable in respect of the lessor to ensure that object that is handed over is used in accordance with the lease agreement. The legal relations that arise when the lessee concludes an agreement on use free of charge or sublet will terminate at the latest upon the termination of the lease.

If real estate is transferred, the new owner of the real estate replaces the old owner as the lessor under an existing lease. However, the new owner can terminate the lease with the statutory notice period. The right to terminate the lease is not vested in the acquirer if the lease agreement was concluded for a definite period in writing and with a 'date certain' (an official confirmation, mostly given by a notary), and the lease object was handed over to the lessee, or if the lessee's rights under the lease agreement have been registered in the respective land and mortgage register.

VII DEVELOPMENTS IN PRACTICE

i Changes concerning corporate income tax

As of 1 January 2014, partnerships limited by shares have been subject to corporate income tax at the partnership level. As a result, partnerships limited by shares have lost their tax transparency, since they are now taxed at the partnership and at the shareholders' and partners' levels. Consequently, investors looking for vehicles that are tax transparent (from the corporate income tax perspective) have in fact only one choice; limited partnerships (general partnerships are also tax transparent, but the partners are liable for the debts of the partnership without any limitation, which discourages investors from choosing this option). It should be noted, however, that attempts were made to also impose corporate income tax at the partnership level in limited partnerships. To date, these attempts have been unsuccessful, but it cannot be excluded that similar attempts will be made in the future.

ii Future changes in the Construction Law and related acts

The government has begun working to simplify and speed up the administrative procedure related to the construction process.

The Building Law Codification Committee (the Committee) has been appointed to unify regulations regarding the construction process, including special development and environmental issues. The Committee has adopted an outline of the Building Code;

this will replace several dozen legal acts that currently set out the rules involved in the investment process, and will comprehensively regulate the process from the stages of deciding on the design and location of the building up to the point of completion of the construction and use of the building. The Committee also plans to eliminate many of the detailed technical regulations regarding building design, and to replace a number of administrative acts (decisions, permits, consents, etc.) currently necessary to obtain a building permit with one uniform building consent. Moreover, many arrangements that currently must be made with different bodies (e.g., the Fire Service or the Sanitary Inspectorate) will be replaced by opinions of those bodies (which are less formalised). Complete, detailed regulation is expected to be ready for presentation to the government in November 2014.

As the new Building Code can only be adopted in 2015 at the earliest, the government is working on a 'small amendment' of the Construction Law, which also aims to simplify the administrative proceeding involved in the construction process. The main assumptions of the small amendment are:

a eliminating the obligation to obtain a building permit or an occupancy permit, or both, for some categories of facilities;

b eliminating the obligation to enclose, with the building design assurance and conditions of supplies by media providers and the road administrator, a statement that the property can be connected to a public road; and

c obligating authorities to perform a formal examination of the application for a building permit (or notification of intended construction) within 14 days of an application or notification being filed.

It is very likely that the small amendment will come into force in 2014.

VIII OUTLOOK AND CONCLUSIONS

The prospects for the real estate sector in particular depend largely on the availability of financing for transactions and development of new projects. However, because of its continued economic growth in recent years, Poland has been, and will probably remain in the near future, an important location for real estate investments, and most likely one of the most important locations in central and eastern Europe. The relatively stable legal situation creates a good environment for real estate investments, attracting many international players. On the other hand, concerns over the general economic outlook and access to financing should not be disregarded as they will affect investors' approach to the region as a whole, influencing the value of transactions and the number of new projects undertaken.

Chapter 27

PORTUGAL

Filipa Arantes Pedroso[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

The definition of property in Portugal follows that of other continental legal systems based on Roman law and the French Civil Code, encompassing not only freehold but also other rights of guarantee and of acquisition. Therefore, the definition of property includes full possession and exclusive use and disposition. In Portugal, there are no trusts,[2] except in the Free Zone of Madeira, where it is possible to incorporate a trust. A person can also own the title to a property while another person has the right to temporarily take the profits and the right to use and manage the property.[3] In addition, it is possible for a person to construct or maintain (permanently or temporarily) a building on land owned by another person, or to plant and maintain crops on such land.[4]

A property may be owned by one or more persons (common property),[5] and it is possible to divide buildings into segments (floors, etc.), which in Portugal is called horizontal property.[6]

ii Registration system

The purchase and sale of a property (arable land and plots of land or buildings) must be executed by a notary or a lawyer, or the commercial and industrial office or the registry

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2 A fiduciary relationship regarding property and subjecting the person with title to the property to equitable duties to deal with it for another's benefit.

3 Article 1439 et seq. of the Civil Code (*usufruto*).

4 Article 1524 et seq. of the Civil Code (*direito de superfície*).

5 Article 1403 et seq. of the Civil Code (*compropriedade*).

6 Article 1414 et seq. of the Civil Code (*propriedade horizontal*).

officers. Certain documents are required for the purchase and sale of a property, notably a licence for use of a building, or a construction licence in the case of urban land. Both documents are issued by the municipality in which the relevant property is located.

The purchase and sale of property must be registered with the Property Registry in order to produce effects against third parties; the Property Registry is part of the Portuguese state. Registration is compulsory with regard to any facts that create, recognise, acquire or modify any real estate rights. The right that is first registered prevails over any subsequently registered rights.

iii Choice of law

The law applicable to the possession, title to property and other real estate rights is defined by the state in which the property is located;[7] therefore, Portuguese law is applicable to the creation, recognition, acquisition or modification of any real estate rights in Portugal.

In the indirect acquisition of real estate, share deals, share purchases and sale agreements may be subject to any other law that has a connection with the persons or companies involved; however, if the company or special purpose vehicle is a Portuguese entity, Portuguese law requirements concerning the sale of shares or of any other participation such as quotas (participation in a company not represented by shares but registered at the Commercial Registry), or units in real estate investment funds, must be complied with.

II OVERVIEW OF REAL ESTATE ACTIVITY

The Portuguese economy was seriously affected by the financial crisis, which undermined the country's economic activity. In an uncertain financial market, the evolution of the Portuguese economy continues to be determined by the necessity of budget consolidation and the strengthening of the process of adjustment to macroeconomic growth with repercussions on economic growth and employment. This situation led to the bailout request to the EU, European Central Bank and International Monetary Fund. The measures required by the memorandum of understanding entered into between those entities and the Portuguese government were adopted, and signs of recovery were visible during the third quarter of 2013.

The real estate investment market was one of the sectors significantly affected by the financial crisis, but recovery is expected in 2014.

Tourism continues to be a main priority for the government. Tourism increased in 2013 by more than 8 per cent, and Lisbon was awarded the best location for city breaks by the European World Travel Awards. China, Russia and Brazil have contributed to the increase of tourism worldwide, and notably in Portugal, Spain, Greece and Italy. Portugal's general tourism offering is very diversified, and its climate and hospitality are highly valued by tourists. However, Portugal's ambitious health tourism project has not advanced as expected. The cross-border health-care Directive,[8] which seeks to facilitate

7 Article 46(1) of the Civil Code.

8 Directive 2011/24/EU of 9 March 2011 on the application of patients' rights in cross-border health care.

access to safe and high-quality health care across EU Member States and promotes cooperation between Member States, has not yet been implemented; the Directive laying down measures to facilitate recognition of medical prescriptions issued in another Member State complements the cross-border health-care Directive, and both are key for the development of Portugal's health and wellbeing tourism project.

III FOREIGN INVESTMENT

There are no restrictions concerning the ownership of real estate by non-resident or foreign investors; they are treated the same as Portuguese nationals or residents. Tourism and activities declared to be of relevance to tourism according to the applicable legislation may be granted tax incentives. Companies established in Portugal may be entitled to a special investment support regime, notably exemption from property transfer tax (IMT) and stamp duty on the acquisition of land and property if considered a relevant investment.

IV STRUCTURING THE INVESTMENT

Real estate can be acquired directly, in an asset deal, or indirectly, in a share deal.

The asset deal is subject to IMT at a rate of 6.5 per cent on the price or patrimonial value (whichever is higher) for urban property (buildings and land for construction), or 5 per cent for rural property (arable or agricultural land). The rate is higher in the case of offshore properties established in certain countries and listed in the applicable law.

The asset deal is also subject to stamp duty at a rate of 0.8 per cent on the price or book value, whichever is higher. Value added tax (VAT) is not applicable; if, however, certain conditions are met, the owner may renounce this VAT exemption, allowing the seller to deduct the VAT paid during construction or any other VAT applied during the course of the business.

The most popular investment vehicles for share deals are commercial companies: the public limited liability company (SA) or private limited liability company (Lda). Other common investment vehicles are the real estate investment fund (FII) and real estate investment company (SIIMO).

In the case of commercial companies, if the real estate is already owned by the company, the above-mentioned transfer taxes (IMT and stamp duty) do not apply when the company is sold; if, however, the company is a quota company (Lda), transfer taxes will apply if the company has only one shareholder or if one of the shareholders holds a participation of more than 75 per cent. Income from real estate is subject to general corporate income tax (IRC) if the property belongs to a company. This tax, at a rate of 25 per cent in 2013, is accrued on a percentage of the taxable profit at the following rates:

Percentage	*Taxable profit*
Zero per cent	Up to €1.5 million
3 per cent	Over €1.5 million and up to €7.5 million
Taxable profit over €7.5 million	
3 per cent	Over €1.5 million and up to €7.5 million
5 per cent	Over €7.5 million

If the property is owned by a person, the income of the property can be included in the overall income of such person and be subject to the applicable tax rate, which ranges from 14.5 per cent to 48 per cent, or be subject to a tax rate of 28 per cent. The owners of real estate are subject to municipal tax (IMI), which rate ranges from 0.3 per cent to 0.8 per cent of the value of the property (a special rate of 7.5 per cent is applicable for properties owned by companies located in tax havens). The IMI tax is paid every year in April, July and November if the tax due is higher than €500. Stamp duty of 1 per cent is due if the value of the residential property is above €1 million.

Any capital gains obtained by the sale of the real estate are also subject to IRC, but 50 per cent may be deductible if, during the following two years, the capital gains are reinvested. Dividends paid by the resident companies or resident individuals are subject to tax at a rate of 28 per cent; non-residents from the EU are exempt from paying taxes in Portugal if their shareholding (shares held for more than one year) amounts to at least 10 per cent, in line with the Parent-Subsidiary Directive. There are various agreements in force in Portugal to avoid double taxation.

FIIs can be open or closed-end funds depending on whether they are incorporated by public or private subscription. FIIs do not have legal capacity, and therefore are managed by management companies or credit institutions. The incorporation of a management company requires the authorisation of the Bank of Portugal, while the incorporation of an FII requires the authorisation of the Securities Market Commission (CMVM) and is then subject to its supervision. SIIMOs have legal capacity and can have variable capital (SICAVI), with a similar regime to the open-end FII, or fixed capital (SICAFI), which has the same regime as a closed-end FII.

In the acquisition of real estate, the open-end FII and SICAVI are exempt from IMT and stamp duty. Closed-end FIIs and SICAFIs whose units are held by qualified investors or by financing institutions pay only 50 per cent of IMT and stamp duty. Regarding the property income of the FII and SIIMO, tax at a rate of 25 per cent applies to the net income, which does not include conservation and maintenance, and IMI. The FII and SIIMO may not deduct the interest of the financing obtained for the acquisition or construction of real estate. The capital gains tax rate is 25 per cent over half of the positive difference between gains and losses made. The management company must pay this and income tax in April of the following year.

The income held by non-residents in Portugal distributed by the FII and SIIMO is exempt from tax in Portugal.

V REAL ESTATE OWNERSHIP

i Planning

The Portuguese planning and licensing legislation is for the most part contained[9] in the Basic Law of Political Planning of the Territory and Urbanism, in the legal regime applicable to territorial management instruments and in the legal regime for licensing and development (the RJUE). The municipalities play an important role in the planning

9 Notwithstanding the Constitution, which contains planning and development principles.

and licensing of real estate projects. Planning in Portugal is carried out in accordance with previous options contained in plans. Therefore, in the development of a real estate project it is important to analyse the applicable rules of territorial management, notably the special plans and the municipality plans.

The rules for the licensing of a real estate project are contained in the RJUE, and aim, in general terms, to confirm whether the project complies with the applicable law. The municipalities are responsible for the licensing of projects, but there are other entities that need to be consulted, and in certain cases their opinions are binding (e.g., the Tourism Authority regarding tourism projects). When construction is complete, a licence must be obtained that confirms that it was concluded in accordance with the approved designs and the terms of the construction licence. This user licence certifies that the relevant building or part can go into use. Tourism projects also need to comply with the legal regime for the installation, operation and functioning of tourism projects.

Certain retail commercial establishments and groups of establishments that have selling spaces above certain thresholds (2,000, 3,000 or 8,000 square metres) require special licences, generally called commercial licences.

ii Environment

The Environmental Liability Law,[10] based on the polluter-pays principle, establishes that, if any damage to the environment occurs or there is a threat of damage due to a private or public economic activity, the entity responsible must take the necessary measures to repair the damage or prevent other damages (administrative liability), and must also repair all damages suffered by the individuals affected by such activities (civil liability).

Criminal liability can arise from damage to the environment such as contamination of soil, which is considered a criminal offence and is punishable by up to three years' imprisonment or a fine equivalent to 600 days of imprisonment, according to the Criminal Code.

iii Tax

The acquisition of real estate is subject to IMT at a rate of 6.5 per cent on the price or book value, whichever is higher, for urban property (buildings and land for construction) or 5 per cent on the price or patrimonial value, whichever is higher, for rural property (arable land). The acquisition of a property is also subject to stamp duty at a rate of 0.8 per cent on the price or patrimonial value, whichever is higher.

Properties are also subject to IMI, paid every year in three instalments in April, July and November,[11] at a rate of between 0.5 per cent and 0.8 per cent for urban properties that were not evaluated in accordance with the IMI Code, and between 0.3 per cent and 0.5 per cent if the property was evaluated in accordance with the IMI Code. Rural properties are subject to a rate of 0.8 per cent. Properties owned by certain offshore entities listed in the applicable law pay 7.5 per cent.

10 Decree Law No. 147/2008 of 29 July.

11 If the amount due is below €250, it is paid in April; if the amount due is above €250 and equal to or below €500, it is paid in two instalments, one in April and the other in November.

The housing stock was evaluated during 2012 and 2013, and the taxable value is now close to market values. Valuation is updated regularly (yearly for commercial real estate and once every three years for residential real estate, as foreseen in the applicable law).

iv Finance and security

A loan agreement secured by a mortgage is the most common financing and security for real estate projects in Portugal. A mortgage grants the creditor the right to be paid a certain amount with priority over other creditors without any special privilege. The mortgage is created by an authenticated private document or by a deed executed by a notary public. The mortgage must be registered at the Property Registry to be effective.

Other security, such as a pledge, is also quite common and usually required in addition to the mortgage by the financing party. If the property is owned by a company, there is a pledge of shares or quotas; the pledge of quotas must be registered at the Companies Registry. The requirements for a pledge of shares depend on the type of shares: bearer, nominative or book entry shares. A pledge of credit rights such as leases, bank accounts, insurance policies or construction contracts is also quite common. The creditor will usually require a pledge over the credit rights that the debtor is entitled to and that represent the main revenue of the project being financed. In certain conditions, the pledge can be qualified as a financial pledge. Personal security is also usually required by the financing party to the shareholders or parent company of the company owning the property.

Financing and security granted in Portugal or to Portuguese companies is subject to stamp duty on the amount of the financing or the maximum amount secured. If security is accessory to a finance agreement and granted simultaneously, the security is not subject to stamp duty, meaning that stamp duty only applies to the amount of the financing. Stamp duty rates are 0.4 per cent if the financing or security is for less than one year, 0.5 per cent if the term is between one and five years, and 0.6 per cent if it is longer than five years.

VI LEASES OF BUSINESS PREMISES

Six years after the enactment of the New Urban Lease Regime,[12] a reform[13] entered into force on 12 November 2012. Lease agreements must be in writing. If a property is sold, the leases do not terminate and are automatically assigned to the new owner of the property. There are two types of leases: housing and commercial. Housing leases no longer have a minimum term, and when parties are silent on this point the lease shall be considered as having been entered into for a fixed term of two years. The main terms of commercial leases continue to be freely agreed between the parties, notably regarding the duration, termination and opposition to the extension. The maximum duration of a commercial lease is 30 years, and if the parties do not establish a duration, the law

12 Approved by Law No. 6/2006, 27 February, which entered into force on 28 June 2006.

13 Law No. 31/2012, 14 August.

provides a default a five-year period; the tenant can terminate the lease with one year's notice.

The parties can also freely agree the responsibility for the maintenance of the leased premises; however, if the agreement does not specify otherwise, the landlord will be responsible for maintenance. The amount of the rent and other costs are also freely agreed between the parties.

The assignment of a lease agreement is subject to the consent of the landlord except in the case of a transfer of an ongoing business, where the lease is included. In this case, the landlord has a right of pre-emption, unless the parties have agreed otherwise. The tenant, however, has a pre-emption right in the sale of a leased premises to a third party, provided that it has been in the leased premises for more than three years; in this case, the parties may not agree otherwise.

Any party may terminate the lease in the case of default of the other party. Termination by the landlord must be declared by a court decision, except in cases of opposition of the tenant to works ordered by public authorities; non-payment of the rent, costs and expenses for two months; or a late payment of more than eight days for more than four times in a row or four times in a period of 12 months. In the first two situations, termination is effective upon communication to the tenant except if, in the following month, the tenant pays the amounts due with a penalty (50 per cent of the amounts due) or allows the works requested. This means that at the very least the tenant remains in the leased premises for three months: two months for the landlord to terminate, and another month prior to paying, not paying or agreeing to the works (a three-month delay counted from the landlord's notification). Law 31/2012 has also introduced a special procedure to expedite the eviction of a lessee and return of the property to the rental market. This reform maintains the existing eviction procedure for the termination of a lease whenever the law imposes the use of the judicial route for that end. Additionally, the Law has introduced the previously mentioned special eviction procedure as a means to terminate effectively the rental agreement, regardless of the rental's purpose, whenever the tenant does not vacate the leased property on the date set by law or determined by the parties for that effect.

Through this procedure, in addition to requiring the vacation of the leased property, the lessor may also cumulatively request the payment of rents, costs and expenses that are the responsibility of the tenant. The law has created the National Office for Leases (the BNA), which has jurisdiction throughout the national territory, to manage the special eviction procedure. The installation and definition of the rules of the BNA and the eviction procedures are ruled by Decree Law 1/2013 of 7 January.

The use of spaces in shopping centres, retail parks, commercial galleries, outlets, offices located in office parks or warehouses located in retail parks that fulfil certain requirements are not considered lease agreements; therefore, the above-mentioned legislation does not apply, as these are non-typified contracts (i.e., contracts not ruled by a specific law). The users of these spaces are not considered simple tenants, as their establishments benefit from common services provided by the management company, notably publicity, security and maintenance of common spaces. In these cases, pre-emption rights, assignments of ongoing business, pledges of lease rights and termination processes do not apply.

VII DEVELOPMENTS IN PRACTICE

Law No. 31/2012 of 14 August (see Section VI, *supra*) seeks to improve access to housing, foster labour mobility, improve the quality of housing, make better use of the housing stock, and reduce the incentives to acquire houses as opposed to lease houses. Law 30/2012 was implemented (also on 14 August) to facilitate works in leased premises.

Decree Law No. 307/2009 of 23 October was amended by Law 32/2012 of 14 August to simplify and introduce flexibility in administrative procedures concerning the creation of areas of renovation, simplify the control of renovation works and include in the concept of renovation certain isolated operations in buildings or parts of buildings, even if located outside the areas of renovation, provided that the construction is more than 30 years old and merits a renovation designed to provide adequate performance and security characteristics.

Under the golden residence permit legislation, a golden visa[14] allows foreign nationals, namely from non-Member States of the EU, to apply for and obtain a residence permit in Portugal when certain type of investments are made (e.g., investments in the acquisition of a property for a minimum amount of €500,000). Around 400 golden visas were issued during 2013, mainly to Chinese parties acquiring property.

VIII OUTLOOK AND CONCLUSIONS

Implementation of the new lease law was an important step concerning the rental market, which is expanding considerably because of the difficulties of obtaining financing to buy houses. Rents are now stabilising in both the housing and commercial markets.

Portugal showed signs of growth by the end of 2013, and so the bailout may be terminated in 2014. The banks are still being carefully monitored, and stress tests undertaken by the relevant European entities. Tourism grew in 2013, and contributed 8 per cent to the exports of Portugal. However, tourism resorts that were in the pipeline have not seen the light of the day. According to the National Strategic Plan for Tourism 2013/2015, enhancing and developing tourism resorts and infrastructures, focusing on the elderly and health care will continue to be priorities.

14 Dispatch No. 11820-a/2012 of 4 September 2012, as amended by Dispatch No. 1661-A/2013 of 28 January 2013.

Chapter 28

QATAR

Louise Wall[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

Qatar is an independent sovereign Arab state, governed in accordance with its Constitution.[2] The Emir is the head of state, with rule following the male hereditary line. The system of government is based on the separation and collaboration of powers. The executive authority is vested in the Emir, assisted by the Council of Ministers. The legislative authority is vested in the Advisory Council, and the judicial authority is vested in courts of law.

Qatar is a civil law jurisdiction with civil and commercial codes as proposed by the Council of Ministers and promulgated by the Emir. Both civil law and shariah law are sources of law, but shariah law is only applicable in the absence of a specific civil law provisions. Usually, the principles of shariah have no application to commercial transactions unless the contracting parties decide otherwise.[3]

Over the past decade, the legal system has been significantly reformed by the enactment of legislation intended to bring Qatari law in line with international laws, standards and practices. There is an ongoing commitment to diversify the economy away from over-reliance on hydrocarbons, to achieve sustainable development and to develop a modern knowledge-based workforce. The Qatar National Vision 2030 aims to achieve this through a programme of managed growth, vast public expenditure on projects in infrastructure, education and professional service development, and by permitting controlled foreign investment to promote specific economic sectors. An estimated

1 Louise Wall is an associate at Dentons.

2 Permanent Constitution of the State of Qatar, approved by public referendum on 29 April 2003, issued on 8 June 2004 and effective from 8 June 2005.

3 Article 1 of Law No. 22 of 2004 Issuing the Civil Law.

US$225 billion will be invested between 2011 and 2016 on infrastructure projects, with the private sector expected to contribute around 58 per cent of funds.[4]

In 2005, the Council of Ministers was given the right to establish free zones to encourage foreign investment.[5] The Qatar Science and Technology Park (the QSTP) was also created in 2005 with an ambition to become the leading location in the Middle East for the development and commercialisation of technology.[6] A separate legal and regulatory regime was also established in 2005 to create and govern the Qatar Financial Centre,[7] primarily aimed at international financial institutions and multinational corporations to encourage participation in financial and professional services in Qatar and the wider Gulf region.

i Ownership of real estate

Interests in real estate are classified as either real property (*in rem*) rights or as personal (contractual) rights. The most common property interests are:

a Absolute: a real property right of complete ownership with the full right to use, exploit and dispose of the property without limit of time.[8]

b Usufruct: there is no legal definition of usufruct under Qatari law, but it is recognised as the grant of a real property right conferring the right to freely use property or land belonging to another person for one's own benefit. The usufructuary may sell, transfer, mortgage or lease the usufruct right, build on it (if it is land), and use and exploit it in any way. It is considered a form of ownership.

c Lease: a contractual right to benefit from a specific property for a limited time against the payment of a financial consideration. Leases are personal rights and not real property.

As a general principle, only Qatari nationals are permitted to own real estate in Qatar.[9] However, a number of exceptions apply allowing non-Qatari investors to acquire real estate subject to certain restrictions. The strictest limitations apply to persons who are not nationals of any Member State of the Gulf Cooperation Council (the GCC); GCC nationals face fewer restrictions. There are no restrictions on ownership of real estate by Qatari nationals.[10]

4 As part of the National Development Strategy 2011–2016 – Qatar National Bank Company Initiation Report, 19 November 2012, p. 2.

5 Law No. 34 of 2005 Establishing Free Zones.

6 Law No. 36 of 2005 Establishing the Qatar Science and Technology Park.

7 Law No. 7 of 2005 Qatar Financial Centre Law.

8 Article 837 of Law No. 22 of 2004 Issuing the Civil Law.

9 Article 1 of Law No. 5 of 1963 Prohibiting the Ownership of Real Properties by Foreigners in Qatar.

10 For legal persons, nationality is determined by country of incorporation and nationality of shareholders.

ii System of registration

Ownership, usufruct and other real property rights must be registered. If registration does not occur, the right is deemed as not validly created or enforceable against third parties. An unregistered right is only a personal obligation between the parties, and is not considered to be a real property right unless registration occurs.[11]

The Department of Real Estate Registration and Authentication (RERA) (administered by the Ministry of Justice) maintains a land register and undertakes the registration of most property.[12] A land certificate is issued to owners and usufructuaries. The registration of the ownership and usufruct of non-Qataris is dealt with under separate rules. In these cases, either the relevant municipality[13] or the relevant competent administration[14] is required to maintain a special register. Details of the special registers must be sent to RERA along with notice of any changes to them.[15]

There is no state guarantee of title, although the Constitution protects a person's right not to be deprived of his or her property.[16]

Leases must be registered at the Lease Registration Office,[17] and each municipality is responsible for maintaining a register of leases within its geographical boundaries.[18]

iii Choice of law

Qatari law governs all rights and dealings in real estate situated in Qatar. Qatari law also applies to any contract concerning Qatari real estate, notwithstanding a different choice of governing law in the contract.[19]

II OVERVIEW OF REAL ESTATE ACTIVITY

While the economic outlook of the wider Middle East and North Africa region remains uncertain, the oil-producing nations of the GCC continue to witness positive growth. Qatar is widely considered as the region's top performer, with its economy being fuelled both by its traditional hydrocarbon sector and increasingly by the strong performance of its relatively new non-oil sectors.[20] Qatar's National Vision 2030 of economic

11 Article 4 of Law No. 14 of 1964 Real Estate Registration.

12 Article 1 of Law No. 14 of 1964 Real Estate Registration.

13 For usufruct rights in the 18 investment areas.

14 For ownership in the permitted areas.

15 Ministerial Decisions No. 4 of 2004, No. 5 of 2006 and No. 6 of 2006.

16 Article 27 of the Permanent Constitution of the State of Qatar. The protection of private property is subject to requirements for public benefit and other cases prescribed by law.

17 Article 20 of Law No. 4 of 2008 Regarding Property Leasing. The Office is maintained by the Ministry of Municipality and Urban Planning.

18 Article 8(14) of Emiri Decree No. 36 of 2009 Organising the Structure of the Ministry of Municipality and Urban Planning.

19 Articles 25 and 27 of Law No. 22 of 2004 Issuing the Civil Law.

20 'MENA and Qatar – The Economic Outlook', Dheeraj Shahdadpuri, *The Edge*, Vol. 4, No. 12, December 2012, p. 34.

diversification and non-oil sector investment, supported by massive public spending on infrastructure projects, is predicted to continue to drive growth and population expansion, and encourage foreign investment.

Real estate construction and infrastructure projects are the focus of current development, with rail, roads, hotels and commercial developments anticipated to receive huge expenditure in the short to medium term. Qatar will invest US$140 billion in transport infrastructure over the next five years, with the first phase of construction of the Doha Metro already under way. The Qatar Tourism Authority plans to spend US$20 billion on new tourism projects, including hotels and new visitor attractions.[21] Further large-scale construction projects are anticipated, including Lusail City and the Qatar-Bahrain Causeway, as well as initial construction work on the stadiums and visitor infrastructure needed to host the FIFA 2022 World Cup.

Reports indicate continued but slower economic growth in 2013 compared with previous years, the decrease being due mainly to the completion of oil and gas sector projects.[22] The number of real estate transactions continues to show strong activity, although the Qatar Central Bank Real Estate Price Index shows falling prices, with a 6.2 per cent drop between May and September 2013.[23] Credit growth is improving, with an increase of 26 per cent in overall credit facilities in 2012 and a further 6.7 per cent in the first six months of 2013. The majority of the lending (42.5 per cent) is still being made to the public sector, with the real estate and construction sector receiving 18.3 per cent of total credit facilities up to June 2013. Strong credit growth is expected in construction and real estate as more projects get under way, with the rate of public sector loans stabilising.[24]

The rental sector continues to show robust performance. Rental rates have remained stable since 2011, and a high level of take up of available office space by public sector occupiers has reduced the rate of empty stock from 16 per cent at the end of 2012 to around 10 per cent as at September 2013.[25]

The real estate market has undeniably opened up to foreign investors in recent years, but the profile of investors remains predominantly that of private Qatari and GCC nationals and government entities. Despite predictions of widespread opportunities for international investment in Qatari real estate projects, the reality is that the current legal and regulatory framework, which remains unsophisticated and highly restrictive when compared with more mature markets, does not support large-scale foreign investment. As a result, potential foreign investors and lenders continue to take a cautious approach, preferring to take up projects in more proven and accessible markets.

Despite this, the current and planned infrastructure and tourism projects will undoubtedly increase opportunities, particularly for those in the construction sector. The expansion of these and other key non-hydrocarbon sectors continues to drive demand

21 Deloitte, 'Are you on the Bench?', May 2013.

22 DTZ Research, 'Property Times Qatar Q3 2013', p. 2.

23 The Peninsula, 24 November 2013.

24 Qatar National Bank, Qatar Economic Insight 2013, p. 18.

25 DTZ Research, 'Property Times Qatar Q3 2013', p. 3.

for available real estate. The easily accessible office rental market is likely to face increased demand from foreign companies driving up rents in 2014, and the corresponding increase in predicted levels of population growth will place unprecedented demand on the already strained residential market.

III FOREIGN INVESTMENT

Ownership of real estate by overseas investors is restricted. Non-GCC nationals and corporate entities, either registered abroad or registered in Qatar but with a non-Qatari shareholder, face the greatest restrictions. GCC nationals and entities also face some restrictions.

The general principle is that non-Qataris are not permitted to own Qatari real estate. This prohibition applies both to absolute ownership and to the right of usufruct.[26] It applies to natural persons, and to companies registered in Qatar but with a foreign shareholding or foreign incorporated companies. There is a specific prohibition against any foreign investment in Qatari incorporated companies that trade or invest in real estate.[27] Despite this, recent relaxations in the law have allowed limited non-Qatari ownership of real estate in Qatar.

i Foreign ownership

Non-Qatari investors may acquire absolute ownership of land, buildings and residential apartments in three specified areas: the Pearl of the Gulf Island, the West Bay Lagoon Project and the Al Khor Resort Project. They may also acquire the right of usufruct over land, buildings and residential apartments for up to 99 years, renewable for similar periods, in specified investment areas.[28] There are currently 18 investment areas, located mainly in Doha and its surrounding suburbs.[29] While the law specifies that foreign investors may acquire usufruct over land, buildings and residential apartments, it is silent in respect of usufruct of commercial accommodation within multi-floored buildings. This means that the general principle still applies, and foreign investors are not permitted to acquire usufruct rights over offices or other commercial premises forming part of a larger building.[30]

There is no restriction on foreign investors acquiring commercial or residential leases.

26 Article 1 of Law No. 5 of 1963 Prohibiting the Ownership of Fixed Properties by Foreigners.

27 Article 2 of Law No. 13 of 2000 Foreign Capital Investment in Economic Activity.

28 Articles 3, 4 and 5 of Law No. 17 of 2004 Ownership and Usufruct Rights of Real Properties and Residential Units by Non-Qataris.

29 Council of Ministers' Decision No. 6 of 2006 Conditions and Procedures for the Usufruct of Real Properties and Residential Units by Non-Qataris.

30 In contrast, acquiring usufruct of the whole of a commercial building in one of the investment areas is permitted.

ii GCC ownership

In addition to the exceptions described above, further allowances apply to GCC nationals.

GCC natural or legal persons and GCC citizens who are licensed to do business in Qatar may own real estate for the purpose of pursuing that business. The property must be appropriate to the business, and cannot be sold unless the business is closing or is being relocated.[31]

As well as the three areas mentioned above,[32] GCC nationals are permitted to acquire absolute ownership of land, buildings and residential apartments in the three further areas of Lusail, Kharayegh and Jabal Thouaileb.[33] There is no limit on the number of real estate assets that can be acquired in these areas. GCC natural persons may also own up to three plots of real estate in residential areas, provided the total area does not exceed 3,000 square metres.[34] Such ownership must only be for the purpose of residential accommodation for owners and their families.[35]

There are no restrictions on GCC investors acquiring commercial and residential leases. The law permits commercial leases to be sold and mortgaged.[36]

iii GCC Economic Agreement

The GCC Economic Agreement aimed to achieve parity of treatment in economic matters between nationals of the GCC states so that any GCC national would be treated in each GCC state in the same manner as nationals of that state. Particular emphasis was placed on equal treatment in respect of acquiring real estate.[37] As a result all GCC nationals should ultimately be able to acquire real estate in Qatar as if they were Qatari individuals or entities – in other words, without restriction.

Qatar ratified the GCC Economic Agreement in 2003, bringing it into force under Qatari law;[38] however, the implementing regulations have yet to be issued,[39] and as a result the provisions are not applied in practice. There is no indication as to when such implementing regulations will be issued, and at present GCC nationals remain subject to the restrictions cited above.

31 Article 8 of Law No. 2 of 2002 Ownership of Real Properties by GCC Citizens.

32 The Pearl of the Gulf Island, West Bay Lagoon Project and Al Khor Resort Project.

33 Council of Ministers' Decision No. 5 of 2006. These areas together form one of the Investment Areas.

34 The Chair of the Council of Ministers may authorise the ownership of more than three parcels, but they must be within the same total area limit.

35 Articles 2 and 3 of Law No. 2 of 2002 Ownership of Real Properties by GCC Citizens.

36 Article 9 of Law No. 2 of 2002 Ownership of Real Properties by GCC Citizens.

37 Article 3 GCC Economic Agreement (signed in Muscat on 31 December 2001).

38 Decree No. 81 of 2003 Ratifying the GCC Economic Agreement; published in the Official Gazette in April 2004.

39 As required by Article 28 of the GCC Economic Agreement.

iv Investment incentives

As an investment incentive, and possibly in recognition of the restrictions on ownership of real estate, non-Qatari investors may be granted long-term leases of 50 years for specific investment projects. The leases are renewable and are granted by the government for specific projects in sectors of importance (e.g., health, education, tourism and industries that promote the development of Qatar's natural resources). The further incentives of exemptions from corporate income tax and custom duties may also be offered to tenants.[40]

IV STRUCTURING THE INVESTMENT

If investors are non-Qatari, the investment structure must take into account the foreign ownership restrictions. For foreign investors, this significantly restricts both the available real estate and the investment vehicle. To date, direct foreign investment has been possible only through relatively unsophisticated company structures.

There is explicit legislation making it unlawful for a foreigner to engage in economic activity contrary to the restrictions on foreign investment and requirements of registration, or for a third party to allow or enable a foreigner to do so. A violation could result in confiscation of assets and profits, imprisonment or a fine.[41] Any structure must also ensure that legal title to the asset can be registered to ensure that the rights are valid and effective against third parties.

i Qatari limited liability company

A limited liability company may be established in Qatar to hold legal title to real estate and to operate a real estate investment business. There are restrictions in relation to the level of foreign shareholdings in Qatari companies. Where there are foreign shareholders, the restrictions on foreign real estate investment also apply.

GCC nationals are permitted to own up to 50 per cent of the shareholding of a Qatari company and non-GCC nationals up to 49 per cent. In both cases, a Qatari must hold the remaining shareholding of 50 per cent and 51 per cent respectively. Such company's real estate investments are restricted to real estate located within the areas where absolute ownership or usufruct by GCC nationals or non-GCC nationals (as appropriate) is permitted. A Qatari company with a foreign shareholding is otherwise prohibited from investing and trading in real estate. There are no restrictions on the company's real estate investments if the shareholding of the company is 100 per cent Qatari (i.e., there are no foreign shareholders).

40 Articles 5 and 7 of Law No. 13 of 2000 Regulating Non-Qatari Capital Investment in Economic Activity.

41 Article 6 of Law No. 24 of 2004 Regarding Combating the Concealment of Non-Qataris Practising Commercial, Economic and Professional Activities Contrary to the Law.

ii Foreign company

A company incorporated outside Qatar may fully own real estate in Qatar provided that the property is located within the areas where foreign ownership is permitted. The significant drawback, however, is that where such investment is for the purpose of pursuing economic activity in Qatar, the law requires such entity to be registered to do business in Qatar.[42] This would necessitate the incorporation of a Qatari company with the requisite Qatari shareholder.[43] A contradiction therefore exists between laws that permit foreign real estate investment on the one hand but require Qatari registration to pursue any economic activity on the other.

iii Shares in a public shareholding company

Non-Qatari investors are permitted to own up to 25 per cent of the shares of public shareholding companies listed on the Qatar Exchange. A number of Qatari real estate companies are listed on the Qatar Exchange, and foreigners may invest in them up to the specified limit. This can be an effective method of real estate investment in an otherwise highly restricted market.

iv Individual ownership

Technically, ownership of real estate for the purpose of pursuing an economic activity would require registration as a business entity; however, a significant number of individuals have purchased residential properties to operate within the rental market. There is clearly no restriction with respect to Qatari nationals, and GCC and foreign nationals may hold absolute title in the permitted areas.

v Qatar Financial Centre (QFC) real estate fund

The establishment of a real estate fund in the QFC is a legal possibility, but one that has not yet been utilised.[44] There are various potential structures that may be used by a QFC fund, including straightforward direct ownership of properties where the fund owns the asset and does not establish separate special purpose vehicles (SPVs) for individual properties to assist in insolvency ring-fencing. This type of structure may be most appropriate for single-purpose plot developments. A more complex alternative is for the fund to establish separate SPVs, each holding title to individual plots or developments, thus ring-fencing the individual asset. This structure carries the advantages of insolvency remoteness and the option to finance at SPV level.

Given the current regime of restrictions on foreign investment, the structure must be organised and segregated to ensure that investments by non-Qataris are made only in SPVs or funds holding legal title in the areas where foreign ownership is permitted.

42 Law No. 25 of 2005 Commercial Registry Law.

43 Exemptions to the requirement to have a Qatari partner may be granted at the discretion of the Minister of Business and Trade, but this is not common and is unlikely to be permitted for the purposes of foreign investment in real estate.

44 To date, one real estate fund has been established in the QFC, but it is not operational.

This requirement, perhaps, makes administration and management of the fund overly burdensome, and seriously limits available assets. There may be added difficulties with registration and transfer of assets in the early stages, until the authorities grow accustomed to dealing with such structures. As this type of structure remains in its infancy, it is difficult to predict how, or indeed if, it will develop, or how attractive it may be in the market.

V REAL ESTATE OWNERSHIP

i Planning

The Ministry of Municipality and Urban Planning has overall responsibility for planning control. Each local municipality has competency to administer and implement planning legislation, deal with planning applications and issue licences for development within its geographical boundaries.[45]

Designated zoning within districts is in place to control commercial and residential uses within appropriate areas. Widespread use of residential properties for commercial purposes is being phased out, with businesses being required to relocate to commercial zones in order to renew trade licences. Industrial uses are restricted to specified industrial zones outside cities and towns.[46]

ii Environment

A significant amount of environmental protection law has been enacted, and several international agreements, conventions and protocols have been approved. There are wide-ranging provisions for the protection of the environment, including the prevention of pollution as a result of development projects. There are substantial sanctions for breaching the various environmental laws, the most significant of which are large financial penalties and imprisonment.

Those wishing to undertake a construction or development project must first conduct an environmental impact study that must be approved by the Supreme Council for the Environment and Natural Resources (the Council).[47] The relevant public authority cannot license a project until such approval is given.[48, 49] There is a requirement for ongoing monitoring of the environmental impact of projects by the relevant authority.[50]

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45 Article 8 of Emiri Decree No. 36 of 2009 Organising the Structure of the Ministry of Municipality and Urban Planning.

46 Ministerial Decision No. 37 of 1990 Industrial Uses Only in Areas Outside Cities.

47 Article 13 of Law No. 30 of 2002 on Environmental Protection.

48 Article 13 of Law No. 30 of 2002 on Environmental Protection and Article 7 of the Executive List of Law No. 30 of 2002 on Environmental Protection.

49 Some minor projects are not required to submit an environmental impact study and obtain approval. Appendix 1 of the Executive List of Law No. 30 of 2002 on Environmental Protection sets out the projects that may not be licensed without approval.

50 Article 15 of Law No. 30 of 2002 on Environmental Protection and Article 7 of the Executive List of Law No. 30 of 2002 on Environmental Protection.

Before the licensing and execution of any project, the developer must also submit plans to the Council for evaluation against its environmental impact standards and controls.[51] The Council may revoke project licences and suspend any activity that is causing an unacceptable environmental impact that was unforeseen at the time of licensing.[52]

The law does not specifically deal with liability for environmental pollution or contamination; it does, however, provide that the project owner must take all actions necessary to stop or minimise negative environmental impacts arising from the project; having conducted an environmental impact study does not release him or her from such responsibility.[53]

Environmental liabilities may pass to buyers on transfer of land ownership. It is therefore advisable to obtain appropriate contractual warranties from the seller and to conduct appropriate surveys before entering into binding contracts.

iii Tax

No transfer tax, value added tax (or equivalent) or stamp duty land tax is payable on the transfer of real estate. Nominal fees based on a percentage of land value are payable to register property rights and interests, and landlords are responsible for paying fees to register leases. Businesses owning or occupying commercial premises must pay fees to obtain and renew trade licences and commercial registrations. Hotels must also obtain a tourism licence, for which fees are payable.[54]

iv Finance and security

The most effective form of security over real estate is the official mortgage. A valid official mortgage is a property right that establishes priority over other secured creditors; priority is determined with reference to the time the mortgage was registered. It also creates priority over all non-secured creditors.[55] In cases of enforcement, where the proceeds of sale of the mortgaged property are insufficient to meet the liability, the mortgagee has recourse against other assets of the mortgagor.

The maximum term of each registration of an official mortgage is 10 years, but registration can be renewed for further 10-year periods.[56] If registration is renewed before the lapse of the previous registration, the period of priority continues from the original date of registration; however, where there is a gap between the expiry of the previous registration and the renewal, any existing priority will be lost and priority will begin from the date of the new registration. If no renewal of registration takes place, the mortgagee loses its right to enforce against third parties and the mortgage reverts to a personal obligation between the parties.

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51 Article 12 of Law No. 30 of 2002 on Environmental Protection.

52 Article 20 of the Executive List of Law No. 30 of 2002 on Environmental Protection.

53 Article 18 of Law No. 30 of 2002 on Environmental Protection.

54 Licensing applies to any person or company operating hospitality facilities and activities.

55 Articles 1088 and 1089 of Law No. 22 of 2004 Issuing the Civil Law.

56 Article 1083 of Law No. 22 of 2004 Issuing the Civil Law.

To create a valid official mortgage, the real estate must be capable of independent sale by auction (such as having a separate registration number) and fully identified in the mortgage deed.[57] In addition, the mortgage deed must be executed as an official document and duly notarised.[58] To have effect against third parties, the mortgage deed must be registered with RERA.[59]

The owner of a building situated on land owned by a third party is entitled to create an official mortgage of that building.[60] The mortgagee acquires a right against the building but not the land.

It is not possible to create an official mortgage over leases. In principle, a type of security can be established by way of an assignment of rights, but the law does not recognise this as formal security and it cannot be registered. As a result, the validity of this type of arrangement to create a security interest and its enforcement are not certain.

VI LEASES OF BUSINESS PREMISES

The rapid pace of real estate development has necessitated new attempts to regulate the retail and office lease market. The relatively new law on property leasing has gone some way to implementing a more commercially minded leasing regime. However, it remains the case that the legal framework still requires significant development to ensure the emergence of a sustainable and mature market, and one that meets the expectations of experienced foreign investors.

The increase of high-end business premises is resulting in improved levels of sophistication in both the drafting and the negotiation of leases. For these premium developments, the use of long-form, English-style precedent leases is becoming the norm. Landlords are keen to secure lettings of newly completed offices and shopping centre retail units to key tenants, and for this there is a willingness to permit tenants' amendments to otherwise standard documents. There also appears to be a slow but increasing use of pre-let agreements as the market gradually matures.

It is still relatively common, however, to find short, basic forms of lease, particularly for older or more established properties and stand-alone retail units. It is also not unusual to come across what may be flippantly termed cut and paste agreements that in practice lack the necessary coherency. There remains reluctance in some areas of the market to use more complex drafting, with a preference to instead rely on the provisions of the legislation.

57 Article 1063 of Law No. 22 of 2004 Issuing the Civil Law.

58 Article 1059 of Law No. 22 of 2004 Issuing the Civil Law.

59 Article 4 of Law No. 14 of 1964 Real Estate Registration and Article 1081 of Law No. 22 of 2004 Issuing the Civil Law.

60 Article 1066 of Law No. 22 of 2004 Issuing the Civil Law.

i Term

The maximum lease term permitted for both commercial and residential leases is 20 years. In practice, commercial lease terms are significantly shorter, often as few as three to five years, with options to renew if both parties agree.

ii Rent and rent increases

Annual rent increases are common, with rents usually reviewed by reference either to the open market rent at the time of the review or to fixed increases. In the past, rent increases have been limited or prohibited, the most recent provision ceasing to have effect in early 2011.

iii Repair

The law provides that the landlord must repair and maintain the property in a fit and usable condition. The tenant is required to keep the property in good condition. This is generally interpreted and accepted in the market to mean that the landlord is responsible for structural and external repairs, and ensuring the tenant can use the property for its permitted use, with the tenant undertaking minor and internal repairs. Leases usually confirm this position unless the tenant is taking a lease of the whole building.

iv Assignment and subletting

Assignment and subletting are not permitted without the written consent of the landlord. There is no requirement for the landlord to act reasonably in granting or withholding consent unless the lease specifies otherwise.

v Termination

The lease will end at the expiry of the contractual lease term. The law allows the landlord to seek permission to terminate the lease early in a number of circumstances, including non-payment of rent, assignment or subletting without consent, redevelopment and demolition. In the latter two cases, certain conditions must first be met. In all cases, the landlord must obtain the permission of the Committee for Settlement of Rental Disputes (the Rental Committee).[61]

Tenants cannot terminate early unless there is a break clause in the lease and usually not without penalty. Many leases contain provisions requiring payment of the rent for the whole of the remaining term should the tenant wish to end the lease early.

vi Security of tenure

There is no concept of security of tenure. There is a deemed renewal of the lease on the same terms if the tenant remains in occupation after the end of the term with the knowledge and without objection of the landlord.

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61 The Rental Committee is under the authority of the Ministry of Municipality and Urban Planning, and has jurisdiction to hear and judge disputes arising from the lease. Decisions of the Rental Committee have the force of law.

vii Registration

The landlord is responsible for registration of the lease. The Rental Committee will not accept any application to hear a dispute if the lease is not registered,[62] but is unlikely to refuse to hear a tenant's application in such cases.

VII DEVELOPMENTS IN PRACTICE

i Automatic extension of commercial leases

Leases of non-residential properties have been automatically extended for two years from 15 February 2012.[63] The extension applies unless the lease agreement already specifies a longer term or the tenant does not wish to extend, and is on condition that the tenant is in occupation of the property. There are a number of exceptions, particularly in relation to leases taken by professional service companies, including leases of law, accountant and engineering offices, and veterinary surgeries. The regulation is silent on whether rental increases are permitted during the period of extension. Previous decisions extending leases have included provisions preventing rental increases except in accordance with specified limits. The absence of such wording in this decision may suggest that rental increases are permitted, possibly because of the strengthening market. While this should not present a problem where the lease includes provisions for market-based increases, it may cause a difficulty where the lease is silent or includes only fixed increases for the duration of the original term. If the parties cannot agree on rent increases in these circumstances, we may witness an increase in cases brought before the Rental Committee for rent determinations.

ii Expropriation of real estate for public benefit

Recent months have seen a marked escalation in activity on large-scale infrastructure projects as pressure mounts to begin development in earnest for the 2022 FIFA World Cup. One key project is the first phase of the Doha Metro, which forms part of the Qatar Integrated Railway Project, a plan to develop four metro lines in Doha, tram routes in West Bay and Lusail, a high-speed line and dedicated freight railways.[64] This phase of the project requires the expropriation for public benefit of areas of real estate in Doha, and a decision permitting the expropriation of land stretching from Doha International Airport to the A Ring Road was recently taken.[65] This will be the first of many such decisions affecting land and existing buildings in Doha as this and other significant infrastructure projects get under way. There is no right to appeal a decision to expropriate land for public benefit, but the landowner and any other person with rights

62 Article 3 of Law No. 20 of 2009 Amending Law No. 4 of 2008 Regarding Property Leasing.

63 Council of Ministers' Decision No. 8 of 2012.

64 www.railwaygazette.com/news/single-view/view/qatar-breaks-ground-on-doha-metro.html.

65 Ministerial Decision No. 100 of 2012.

over the property have a right to fair compensation.[66] If monetary compensation is not acceptable to the landowner, then alternative real estate may be offered instead.[67]

iii Residence permits for foreign owners

The Minister of Interior may issue residence permits to foreigners who have acquired absolute ownership of real estate or the right of usufruct[68] without the usual requirement that a foreign individual has obtained a working or dependent family visa. The wording of the law allows the Minister of Interior discretion to grant or refuse applications, and it is therefore neither mandatory nor guaranteed that residence permits will be granted. Each permit is granted for five years and is renewable, but will be cancelled as soon as ownership of the asset ceases.

iv Civil defence changes applicable to real estate owners and tenants

Recent changes to the law on civil defence have increased safety and ongoing monitoring requirements that will affect all property owners and tenants. The approval of the Ministry of Interior's Civil Defence Department is now required before and after the completion of a building project, and buildings and projects must comply with ongoing improved safety and security standards. These include, in particular, proper measures and procedures for emergency escape, evacuation and access for emergency vehicles. In addition an owner or tenant must obtain prior permission from the Civil Defence Department before changing the activity permitted to be carried on in the property, and before making any modifications to the original design and layout, including changes to internal fit-out. The issue of new or renewal trade licences that are mandatory for individual business premises (whether stand-alone or forming part of a larger property) is not permitted unless the building has a valid Civil Defence Department certificate confirming that it complies will all safety and security requirements.[69]

VIII OUTLOOK AND CONCLUSIONS

The changes in real estate law from 2004 onwards opened up the real estate market to non-Qataris for the first time in decades. At the time, there was much anticipation that this would be the first step to significant foreign investment in a new and fast-paced premium real estate market. The reality was somewhat different, as changes to the relatively unsophisticated regulatory framework did not keep pace with the faster scale of property development. Early investors faced issues with registration of legal title

66 Article 2 of Law No. 13 of 1988 Expropriation of Real Estates and the Temporary Appropriation thereof for Public Utility, as amended.

67 Article 17 (repeated) of Law No. 13 of 1988 Expropriation of Real Estates and the Temporary Appropriation thereof for Public Utility, as amended.

68 Law No. 4 of 2009 Regulating the Entry, Residence and Sponsorship of People Entering Qatar. Ownership and usufruct must be obtained in accordance with the provisions of Law No. 17 of 2004 (see Section III, *supra*).

69 Law No. 9 of 2012 Regarding Civil Defence amending Law No. 13 of 1997.

and lenders' security, significantly delayed completions and, in some cases, contractor default. These difficulties, together with the economic downturn and the near collapse of the Dubai real estate market, further impacted the number of investors and lenders prepared or able to enter the Qatari market.

Investors are returning to the market, but investor analysis shows that the majority are still local investors taking advantage of public sector pay increases and interest free development loans, and government entities funding new developments.[70] Further relaxation of the restrictions on foreign investment as well as development of the regulatory framework is needed if a broader and more sophisticated range of investors is to be persuaded to enter the Qatari real estate market.

One potential development would be the establishment of new investment free zones similar to those seen in other GCC states, where foreign investors are able to establish business entities, purchase freehold title within the free zone's boundaries and pursue economic activity without the usual restrictions. While the law is in place to allow this development,[71] and a steering committee has been established to consider implementation and regulation,[72] to date no free zones have been established under these provisions. The QSTP was created pursuant to a separate law and under the authority of Qatar Foundation and, although considered a free zone, there is no right to acquire land there, and it is limited to the pursuit of science and technology. The development of new investment free zones could significantly broaden the real estate available to foreign investors, and would be a genuine opportunity to encourage long-term direct investment.

The Qatar Exchange has mooted a proposal to develop a real estate investment trust regime as part of an overall development strategy for the Qatari market.[73] This would require significant new legislation concerning not least trust law, which is not formally recognised under Qatari law, and a new and more rigorous regulatory framework. It would, presumably, also necessitate the broadening of foreign ownership and investment rights. To date this remains a proposal, albeit an apparently serious one, and there is no indication of how or when steps might be taken to implement a regime; however, this would be a welcome development and an important, possibly crucial, step towards establishing a sophisticated and sustainable real estate market that encourages greater participation from both local and foreign investors.

70 DTZ, 'Property Times Qatar Q3 2012', pp. 6 and 7.

71 Law No. 34 of 2005 Establishing Free Zones.

72 Emiri Decision No. 21 of 2006 Organising the Steering Committee for establishing investment free zone areas.

73 www.world-exchanges.org/news-views/qatar-exchange-expands-range-benchmark-and-tradable-indices.

Chapter 29

ROMANIA

Silvia Opris (née Popa) and Ionuţ Sava[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

Romanian law recognises exclusive ownership, co-ownership and time-shared ownership.

An exclusive owner generally has full enjoyment of the property and bears all related obligations. In contrast, co-ownership means that each co-owner holds a share of the ownership right and may freely dispose of his or her share. The co-owners enjoy the benefits and bear the obligations related to the property *pro rata* with their ownership share. Each co-owner may act to preserve the asset without requiring the consent of the others. On the other hand, use and management of the asset will generally require the other co-owners' consent, while disposition acts affecting the entire asset always require all the co-owners' consent.

Time-shared ownership was introduced by the new Civil Code, which entered into force on 1 October 2011. It refers to exerting ownership over an asset, successively and repeatedly, at determined time intervals – equal or not – by different persons.

As a rule, building permits may be issued only to holders of a real right (right *in rem*) to the relevant property. The recommended choice for the investor for project development is exclusive ownership, granting it full control over the asset in question and over its development. Nevertheless, developers have preferred to acquire *superficies* rights, allowing them to secure real rights over the real estate (necessary for the permits to be obtained) without allocating large amounts up front, and thereby keeping the costs low in the development phase.

Romania established a nationwide land registration system of real estate in 1996. Prior to this date, two systems of land registration were in force: the land register system (a property register system) valid in the regions that used to be part of the

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Austro-Hungarian Empire before the First World War,[2] and the inscriptions and registration system (a proprietorship register system), valid in the remaining regions of the country. Land registers are currently being set up for all properties that have not previously been entered into land registers.

According to the general cadastre system established by Romanian law, all real property is identified by a cadastral number and registered in a land register.

The new Civil Code provides that real rights over properties are to be established between the parties and towards third parties only by way of registration in the land register. Registration, therefore, becomes a condition precedent for ownership or other real rights to be validly transferred (except as otherwise provided by the law). This provision will enter into force only after completion of the cadastral works for each administrative-territorial unit, and will apply to the legal acts concluded and facts arising after the entry into force of the new Civil Code. The constitutive effect of the registration or deletion of a real right from the land register is one of the major changes being brought in by the new Civil Code.

The ownership and other real rights over property, including real warranties and possession, are governed by the law of the state where the property is located. Consequently, even if the parties to a transaction are in principle free to choose the law applicable to contracts they enter into, insofar as they contract in respect of property located in Romania, the foregoing will be governed by Romanian law. In addition, for the parties to be allowed to choose a foreign law as applicable, the transaction must contain a foreign element (e.g., one of the parties is a foreign national).

II OVERVIEW OF REAL ESTATE ACTIVITY

The real estate investment market is not generally expected to make a dramatic recovery during 2014. We expect to see some developments in agriculture and infrastructure works, with some office or mixed-use projects on the horizon.

Due to the changes concerning the support scheme and newly introduced conditions for the distribution of green certificates, it is expected that investment in renewable energy projects (and in particular in photovoltaic plants), which has been rising in the past few years, will decrease.

Banks have shown interest in financing sound projects, with a positive legal and technical due diligence result being an important factor for the financing decision.

III FOREIGN INVESTMENT

Nationals of Member States of the European Union or of the European Economic Area (the EEA), or stateless persons having their lawful residence in a Member State but who do not reside in Romania, may acquire ownership over non-agricultural land in Romania under the same conditions as Romanian citizens and legal entities. From 1 January 2014, the restrictions concerning agricultural lands, forests and forestry lands

2 Banat, Transylvania and Northern Moldova.

shall also be lifted. However, the government has announced that it will enact specific regulations to deter speculative purchases. The government is currently working on a law proposal attempting to regulate the sale of agricultural land to natural persons. One of the most important provisions in the proposal is the establishment of a pre-emption right in favour of co-owners (natural persons), leaseholders under an agricultural lease, neighbours (natural persons), natural persons under the age of 40 who are carrying out agricultural activities within the administrative area of the locality where the land in question is located, and the Romanian state. The proposal specifies that contracts concluded in breach of the pre-emption right are void. Other foreign citizens, stateless persons or legal persons registered in other countries may acquire ownership rights over lands under the conditions established by international treaties, on a mutual basis; however, such parties may not acquire ownership of land in Romania under conditions more favourable than those available to the nationals of a Member State.

Nevertheless, companies having their registered seat within Romanian borders (and thus having Romanian nationality) may freely acquire land, even if their share capital is entirely foreign. In addition, non-Romanian citizens and legal entities may freely acquire buildings and the right to use the land such buildings are located on (e.g., by obtaining a right of *superficies* over the land).

IV STRUCTURING THE INVESTMENT

When assessing the structures to be used for an investment project, the most common options available to an investor would be to conclude the transaction:

a as a share deal, so the investor buys into the share capital of the company, becoming a full or part owner of the target company; or

b as an asset deal, so the investor acquires all or some of the assets of the company rather than the shares.

If the interested parties are natural persons, the second option is the easiest way to proceed.

If the potential seller is a company or a special purpose vehicle, the most common type of company used is a limited liability company owing to the applicable, rather flexible, rules on corporate governance and the relatively uncomplicated incorporation procedure.

If the seller is a legal person, investors will look at structure-specific risks as well as tax efficiency when assessing the two options above. One of the risks of a share deal may be the unknown liabilities in the target company. In a share deal, all these liabilities would remain in the company (and would be taken over by the investor), whereas in the case of an asset deal, liabilities would remain with the selling company.

In addition, if the purpose of the acquisition lies in the specific development envisaged, transferability of permits will be an important assessment factor. If some or all of the permits are not transferable, a share deal may be preferred over a more complex structure in which the asset is transferred and permits are assigned or renewed.

While from the investor's perspective there may be no obvious preference between an asset and a share deal in terms of taxation, the seller may have a clear preference for a share deal. A share deal ensures that the seller has immediate access to the purchase price, whereas corporate rules on dividends and corporate profit would need to be observed in an asset deal, resulting in the availability of the purchase price to the seller's shareholders only at the end of the financial year. In addition, the corporate tax applicable in an asset deal will generally be higher than the corporate gain tax, even though they are of the same percentage, given the difference in the taxable base.

Moreover, share deals avoid certain formalities and fees since they involve no transfer of title to real estate. In an asset deal, the transfer of real rights over real estate is subject to certain mandatory formalities (e.g., a notarised deed and, in future, registration with the land register). In contrast, in the case of a share deal, transfer of shares is rarely made in notarised form, and there will be no (additional) registration with the land register. In general, when an asset deal is preferred, it is common practice for the purchaser to bear all notary fees and land registry taxes and VAT (if applicable).

In practice, therefore, the investor should consider each case separately, assessing which party assumes the risks related to the transfer of the property, real estate contracts and permits, and which structure will be tax-friendly for the seller (to avoid the seller including applicable taxes in the purchase price).

In addition to the above, Romania will be implementing holding legislation as of 2014. Essentially, new tax rules will allow certain exemptions under conditions that will usually be fairly easy to meet (e.g., the company should be resident in the EU or in another country with which Romania has a double tax treaty; a minimum 10 per cent holding; a minimum holding period). Investors may consider using this structure for their projects, as it may have some advantages, including lower administrative costs and the possibility of using the mechanism irrespective of whether the business is active or passive.

V REAL ESTATE OWNERSHIP

i Planning

Building is permitted only within built-up areas on non-agricultural land, and only with a valid building permit. Building on agricultural land (i.e., land that is part of the agricultural circuit) is in principle forbidden, with the exception of construction for agriculture, railways and important roads, high-voltage electricity lines, oil and natural gas exploitation works, main oil or gas pipelines, water management works and constructions intended for military use.

Land may be included within a built-up area by the local authorities upon request by the interested party. The latter will draft a zoning plan (PUZ) and submit it for approval by the local authorities. Following the approval of the PUZ for the extension of the built-up area, the general plan is updated.

As a general rule, agricultural land must be withdrawn from the agricultural circuit before buildings may be sited on it; the law stipulates a specific procedure in this regard. Nevertheless, lands located within the built-up area that are evidenced as designated for construction will be withdrawn from the agricultural circuit upon issuance of the building permit. If the applicant for the building permit shows that only a part of the concerned land should be withdrawn from the agricultural circuit, it must present the relevant cadastral documentation to the authorities together with the building permit application. To protect agricultural land, a recent amendment of the Law approving the support system for energy produced from renewable sources[3] has provided that energy produced on land in the agricultural circuit at 31 December 2013 shall not be eligible for the support scheme.

If the applicant requests a change of planning documents, the authority may:

a reject the application;

b approve the investment on the condition of the drafting and approval of a plan by the local authority of a PUZ;

c approve the investment on the condition of the drafting by the investor of a plan and approval by the local authority of a PUZ – for rather large investment projects (industrial parks, supermarkets, hypermarkets, transport infrastructure, etc.);[4]

d approve the investment on the condition of the drafting and approval of ea detailed plan; or

e allow the drafting of the technical documentation if the neighbouring buildings are of the same height within a continuous, already built row of buildings.

Another change in law that may impact the development of real estate projects is the requirement to draft a PUZ in order to perform a partitioning of land in more than three plots.

ii Environment

Romanian law implements the polluter pays principle.

In accordance with the general regulations on environmental liability, any party[5] shall bear the costs for measures taken for the prevention and repair of environmental damages or the imminent threat of such damages, unless it can prove that the environmental damage or the imminent threat of such damage was caused by a third party and has occurred despite adequate measures having been taken, or the environmental damage or the imminent threat of such damage was caused as the result of compliance with a mandatory instruction issued by a public authority.

iii Tax

A transfer tax for the conveyance of ownership (or components of the ownership right) over real estate is only applicable to sellers that are natural persons, and will vary

3 Law No. 220/2008 for the system to promote energy production from renewable energy sources.

4 The investor may be the drafter of the PUZ only in cases where the proposed development will involve at least 10,000 square metres for residential properties or 5,000 square metres for commercial facilities.

5 Any legal or natural person carrying out or controlling a professional activity or who has been granted economic powers over the technical functioning of such an activity, or who is registered or notifies the performance of such an activity.

depending on the duration of ownership before the transaction. If the seller has owned the property for three years or less, the tax will be 3 per cent of a purchase price below 200,000 lei, or 6,000 lei plus 2 per cent of the amount exceeding 200,000 lei. If the seller has owned the property for more than three years, the tax will be 2 per cent of a purchase price below 200,000 lei, or 4,000 lei plus 1 per cent of the amount exceeding 200,000 lei.

VAT amounts to 24 per cent of the purchase price and is applicable to real estate transactions executed by natural persons acting independently, conveying the ownership permanently with the purpose of obtaining gains.

In respect of transactions concluded by legal persons, as a rule, such operations are VAT-exempt (unless the legal person is VAT registered); however, VAT must be paid for the delivery of new buildings, parts of new buildings, etc. Seeking advice from a tax consultant to identify the most appropriate solution for each transaction is recommended.

A recent amendment to the Fiscal Code[6] has established a new ownership tax on the constructions in the patrimony of privately owned legal persons. The tax amounts to 1.5 per cent of the value of the respective property, as registered in the patrimony of the legal person on 31 December of the previous year. The constructions at hand are categorised in:

a industrial constructions;
b agricultural constructions;
c constructions for transport and telecommunications;
d hydro-technical constructions;
e constructions for business, trade or storage;
f housing and social-cultural constructions;
g constructions for the transportation of energy;
h constructions for water supply, sewage and land improvements;
i constructions for the transport and distribution of oil, gas, industrial liquids, compressed air and for heating; and
j other constructions not mentioned in the categories above.

It is envisaged that the new tax shall impact the energy sector (producers, distributors, legal persons owning transport infrastructure for energetic products) and the telecommunications sector.

iv Finance and security

The most common form of security is the mortgage. Typically, the mortgage grants the holder (the mortgagee) the right to pursue the mortgaged property and to be preferred against other (unsecured) creditors in the event of foreclosure. The owner of the mortgaged property (the mortgagor), however, does not lose ownership or possession of the mortgaged property unless the mortgage is foreclosed.

6 Government Ordinance No. 102/2013 amending and supplementing Law No. 571/2003 regarding the Fiscal Code and for regulating some financial and fiscal matters.

The mortgage becomes effective by registration with the land register. A mortgage may be established over a future building, but will be subject to temporary registration in the land register until the building is finalised.

VI LEASES OF BUSINESS PREMISES

The lease of commercial premises is regulated by the general provisions on lease agreements. The parties may generally derogate from these provisions by way of contract.

Lease agreements may generally be concluded for a maximum term of 49 years. If no term is provided in the agreement, the lease is presumed to be concluded for one year for unfurnished premises, and for the time increment for which the rent was calculated for furnished premises.

The rent and its indexation are freely negotiated by the parties. There are no legal provisions on the indexation of rent.

The lessor or landlord must hand over the asset, maintain the asset during the lease period by performing all necessary repairs (except for small repairs concerning the daily maintenance of the leased asset) and ensure 'peaceful enjoyment' of the leased asset.

The tenant must take over the asset, pay the rent, use the asset with due care and diligence, and return the asset upon termination of the lease. The leased asset should be used in accordance with the purpose established in the agreement or, in lack thereof, in accordance with its nature or its previous use. If the lessee performs changes on the asset, changes the use of the asset or uses the asset in such a manner that it causes damage to the landlord, the latter may claim damages from the tenant and, if appropriate, terminate the agreement.

The lessee must notify the lessor or landlord in respect of any required repairs, under the penalty of paying damages.

Subletting and assignment of the lease is allowed unless the parties agree differently. The prohibition of subletting the asset includes assigning the agreement to a third party.

The lease agreement is usually terminated by the expiry of its term, without any notice requirement. If the tenant continues to use the asset without any opposition from the landlord, the agreement is considered renewed under the same conditions (including the guarantees), for an indefinite period (unless otherwise provided in the agreement). The parties may provide that the agreement is terminated in the case of the sale of the leased asset.

If the lease agreement was concluded for an indefinite period, the lease agreement may be terminated by either party by written notice. The notice is effective only after the expiration of the notice period.

Lease agreements concluded in notarised form or registered with the fiscal authorities are directly enforceable in respect of the payment of the rent on the terms and modalities established in the agreement, and return of the leased asset, if the lease agreement has been concluded for a determined period.

VII DEVELOPMENTS IN PRACTICE

i Entry into force of the new Civil Code

The most notable development in real estate law in recent years was the entry into force of the new Civil Code on 1 October 2011. The new Civil Code brought long-awaited changes, some in line with the case law and academic writings previously supplementing gaps in the old Code, some settling old disputes and some bringing innovations to the Romanian system as a whole.

As a general rule, the new Civil Code applies to agreements concluded after 1 October 2011, whereas the agreements concluded before 1 October 2011 will still be governed by the law in force at such time. Certain distinctions or exceptions of interest for real estate law concern (liability for) hidden defects, status of sold assets and disagreements between parties on the quality of the asset sold.

One of the major changes proposed by the new Civil Code is the constitutive effect of the registration of real rights with the land register (see Section I, *supra*); however, it has yet to be announced when this change will come into effect.

Real rights are better and uniformly regulated, the right of *superficies* being coherently regulated for the first time in Romanian law. In practice, the market has reacted positively to this, and we are seeing a growing number of projects being developed based on *superficies* rights.

In respect of real guarantees, the new Civil Code brings in new contractual structures: the mortgage or the rank of the mortgage may be assigned independently of the guaranteed receivable, when the amount for which the mortgage was established is precisely determined in the document establishing the mortgage. The assignment must be made in written form, between the assignor creditor and the assignee creditor, and the debtor must be notified accordingly.

In addition, recent changes to the Cadastre and Real Estate Publicity Act[7] provide that the assignee of a receivable guaranteed with a mortgage may request the transfer of the mortgage registered with the land register on the basis of the assignment deed concluded in notarised form. If the receivable guaranteed with a mortgage was, in its turn, pledged, the debtor may raise against the beneficiary of the pledge the defences that it may have claimed against its creditor, if such defences were based on causes that occurred prior to the notification or consent to the pledge of the receivable.

In terms of real estate management, Romanian law recognises the regulation of trusts, a common law concept increasingly used in civil law systems. Any person may grant the trust, while to avoid money laundering and tax evasion, the trustee must be a credit institution, a financial investment company, or a notary public or attorney-at-law.

Regulation of construction contracts has become more detailed in terms of the parties' rights and obligations, as well as their responsibilities. In particular, there is stricter regulation of amendments of the price and new provisions regarding the contractor's obligations to keep his or her employer informed. These aim to ensure parties'

7 Law No. 7/1996.

performance and to limit cases where fault for non-performance and risk allocation are difficult to determine.

ii Increased protection of pastures and agricultural land

Throughout 2013, the Romanian legislator has paid increasing attention to the use of pastures and agricultural land, and has included measures to protect such lands from development that would involve changing their designation.

Legislation regulating the regime of pastures[8] heavily restricts situations where pastures may be re-designated as constructible land, and provides for a strict re-designation procedure. One of the most affected industries appears to be the photovoltaic energy industry. Whereas the new law allows renewable energy projects in general to be placed on pastures, an explicit prohibition is established in this regard for photovoltaic parks.

Moreover, we expect 2014 to bring about legislative amendments as concerns the transfer of agricultural land (see Section III, *supra*).

iii New Code of Civil Procedure

As part of a larger legislative reform, the new Code of Civil Procedure entered into force on 15 February 2013.

In brief, the main changes concern better, faster litigation procedures, and also unifying court practice. The provisions of the old Code of Civil Procedure continue to apply to disputes commenced prior to 15 February 2013.

It is believed that the introduction of a first stage in a court dispute (a written stage), during which the parties prepare and present their claims, means of defence and their proof to provide a clear outline of the dispute, should lead to a speedier and better-organised trial.

iv New regulation regarding the restitution of properties

2013 saw the coming into force of a new Law aimed at completing the property restitution process,[9] which has already been amended twice. The Law applies to all restitution claims submitted within the prescribed period to the competent authorities and not yet solved, and the claims objects of court cases, including those cases before the European Court of Human Rights and those suspended on the basis of the pilot judgment in *Maria Atanasiu and Others v. Romania*. The Law establishes committees to perform an inventory of the lands that may be the object of the reinstatement of the ownership right and to implement a mechanism aimed at completing restitution in kind claims by 1 January 2016. For those cases where restitution in kind is not possible, the Law establishes a new compensation mechanism whereby the entitled person receives a certain number of points corresponding to the claimed property, which may be used either for acquiring

8 Government Emergency Ordinance No. 34/2013 on the organisation, management and exploitation of permanent pastures, and amending the Land Resources Law No. 18/1991.

9 Law No. 165/2013 regarding the measures for completing the process of restitution, in kind or equivalent, of the real properties abusively seized during the communist regime in Romania.

real properties listed in a national fund (starting from 1 January 2016) or for receiving the cash equivalent (in yearly instalments, starting from 1 January 2017).

VIII OUTLOOK AND CONCLUSIONS

The renewable energy sector has so far had a tremendous impact on real estate development; however, due to changes in the renewable energy support scheme, we expect this impact to decline in 2014. In this context, it appears that agricultural developments will be the next area of interest, and it will be interesting to follow whether and how the authorities will enact and implement regulations restricting the acquisition of agricultural land, not only by citizens of EU and EEA Member States, but also by Romanian nationals.

On a different note, the authorities might take some additional measures in the implementation of the new restitution regulations; it remains to be seen whether the new regulations and implementing measures will meet the requirements of an effective restitution and compensation mechanism for the victims of the former communist regime as set out by the European Court of Human Rights.

Chapter 30

SCOTLAND

Michael Henderson and Nick Ryden[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

There is only one form of ownership of real estate in Scotland: that of outright ownership. However, real estate – known as heritable property – can be used by the owner or occupied by a tenant under an occupational lease. Investment leasehold interests can also be granted, typically for a premium and subject to a nominal rent, or a rent calculated with reference to the actual or potential income derived from the occupational tenants. Most investors in property in Scotland, as elsewhere in the UK, are likely to be interested in property that is occupied by a tenant on a full repairing and insuring lease. In this way, the investor will receive a revenue stream from the rental income paid by the occupational tenant, who will also be responsible for all costs of repair and maintenance of the property and insurance of the property against normal risks such as damage or destruction by fire, flooding and storm damage.

Ownership of real estate may also be held in common by two or more owners. Each owner will hold an equal share in the property along with the other owners, unless some alternative division of shares is specified in the title to the property. Such shares are referred to as *pro indiviso* shares (i.e., undivided), the effect being that each of the owners has an indivisible share of the whole of the heritable property in question.

i System of registration

Registration of title to real estate in Scotland currently operates by reference to two separate systems: the original Register of Sasines, which is a register of deeds, and the newer Land Register of Scotland, which is a register of title (or interests) set up by

1 Michael Henderson and Nick Ryden are partners at Shepherd and Wedderburn LLP. The authors would like to acknowledge the invaluable assistance of Ann Stewart, senior professional support lawyer, in the production of this chapter.

the Land Registration (Scotland) Act 1979. The plan-based Land Register is gradually replacing the Register of Sasines. Both are overseen by the Keeper of the Registers of Scotland, and are accessible to the public.

The Land Register is based on the Ordnance Survey (OS) map, and for real estate to be registered in the Land Register it must either be delineated on a plan or sufficiently described so that it is capable of being plotted onto the OS map. When property that is recorded in the Register of Sasines is sold, that transaction will induce first registration into the Land Register. It is only by having title recorded or registered in one of the registers that an owner of real estate obtains a real right to the property, that is, a right that is protected from challenge.

Title recorded in the Register of Sasines does not benefit from any state guarantee; however, once title to real estate is registered in the Land Register, a state guarantee, known as the Keeper's indemnity, is available against certain defects and challenges. This is not a comprehensive guarantee, and there are a number of statutory exceptions to the indemnity. Short leases (less than 20 years) and some other rights do not need to be registered to be effective. Such overriding interests will bind a purchaser and should be uncovered by a solicitor's due diligence process.

ii Choice of law

Real estate may be characterised as heritable or immoveable property. Generally, for immoveable property the choice of law will be the law of the country in which the property is situated. For the purposes of any dispute, land and buildings on land are immoveable. Where a right has both moveable and immoveable elements, such as the right of a heritable creditor to recover monies secured by way of a standard security (fixed charge over real estate), the right is categorised as immoveable by virtue of the security.

Real estate law in Scotland is different from real estate law in England and Wales, and Northern Ireland, and consequently specialist advice will be required where other jurisdictions are involved; however, certain areas of law, such as taxation, currently apply throughout the United Kingdom, although the provisions of the Scotland Act 2012 prospectively change the position (see Section VIII, *infra*).

II OVERVIEW OF REAL ESTATE ACTIVITY

Building on the trend of increased investment activity in the latter half of 2012, there has been a significant increase in such activity in 2013. The weight of money to be invested in property has cascaded out from London to key regional cities across the UK in an attempt to find greater value and increased availability of mainly prime assets. Competition has increased from both UK and foreign investors. One of the key consequences of the credit crunch has been a polarisation of the UK real estate market between primary and secondary assets. Well-let investments in good locations are very attractive, while for other assets without these characteristics, the picture remains less positive.

There continues to be an appetite for many annuity and pension funds for investments let on long leases to local authorities, universities and other highly rated entities. Typically, the rent for such investments is reviewed in accordance with increases in the Retail Price Index with suitable collars and caps applying. Student housing remains a growth area as higher education institutions continue to attract UK and international students.

A number of banks remain under pressure to dispose of under-performing real estate-backed loan portfolios. Non-core divisions or 'bad banks' have been created to focus on the disposal of these unwanted assets, and the packaging and sale of loans is likely to continue alongside consensual sales driven by lender influence. While there has been an increase in confidence in the banking sector, the availability of debt finance remains below that of pre-credit crunch levels. The banks continue to be selective as they continue to rebuild their balance sheets. New sources of funding from investment managers, insurance companies and private equity have helped to fill the gaps left by the banks.

Investors and lenders continue to show reluctance to climb the risk curve, although in markets where there is supply constraint we are seeing some interest in very good secondary offices; for example, Edinburgh has witnessed good take up of mainly new office space by occupiers over the past year), while take up of offices in Glasgow has also improved over the year. Both Central Belt cities are seeing the supply of Grade A space diminish. Aberdeen continues to be driven by the energy sector, where occupational, development and investment activities remain buoyant. Outside of prime locations, the retail sector remains weak, with continuing high-profile tenant insolvencies. While pressure remains on the high street, a number of retailers are succeeding by successfully combining their 'bricks and mortar' offer with an online 'click and collect' offer.

The UK government's Help to Buy and Funding for Lending schemes have assisted in opening up the residential mortgage market. This has contributed overall to improved market conditions. There is increased confidence among house builders predicting improved pricing at least in the short term. Regeneration activity continues in Glasgow in the run up to the Commonwealth Games in July and August 2014. Significant investment in renewable energy projects in Scotland and the UK has also continued, with further investment expected across the industry.

III FOREIGN INVESTMENT

Overseas investors are able to own, sell and lease real estate in Scotland without restriction. Tax may be payable, however, on income derived from such real estate investments. A legal opinion may be required to confirm that a foreign investor has legal power to enter into a transaction involving property in Scotland, to deal with the property and to sign the relevant documents.

Some international investors operate in a regulated environment where, for instance, the approval of the custodian bank of the investment fund is required to dispose of the property in question. There may also be a need to ensure that an entry in the relevant land register is made to allow the custodian the ability to monitor this. Unlike some other jurisdictions in the UK, the Scottish Land Register will not accept the registration of such a limitation; however, this issue can be addressed satisfactorily in other ways.

IV STRUCTURING THE INVESTMENT

A number of alternative structures are available for direct or indirect investment in real estate both in Scotland and in England and Wales. The decision how best to structure such an investment is likely to be dictated by tax considerations, and it is important to ensure that appropriate tax advice is sought, taking into account both UK tax legislation and that of the investor's own jurisdiction. There are, however, a number of advantages and disadvantages to each structure that may also prove critical depending on the investor's particular objectives.

i Corporate entity

A company can hold assets in its own name and create floating charges. There is potential for flexibility in terms of share structure, and there can be the advantage of limited liability. More generally, corporate entities are widely recognised and can promote a strong and legitimate identity. Nonetheless, there is a lack of confidentiality in comparison with other investment structures, and the added administrative burden of complying with the relevant regulatory framework. There is also a lack of tax transparency, and it may be expedient to base the company offshore.

ii General partnership

While property co-ownership is not in itself sufficient, the active, joint management of property may constitute a partnership; it is a matter of substance rather than form. Most partnerships, however, will be subject to a written agreement regulating the terms. In Scotland, a partnership has a distinct legal personality that is separate from the individual partners, and so can own property in its own name. More usually, however, the partners will hold title to property as trustees for the firm, which is considered to provide more flexibility.

The key advantage of using a partnership is tax transparency, while the main disadvantage is the unlimited liability of the partners in relation to partnership debts.

iii Limited partnership

In a limited partnership investors will be limited partners who are only liable to the extent of their investment. This limited liability is particularly advantageous when coupled with the tax transparency that, to an extent, is offered by a limited partnership. A limited partnership, however, must comply with the Limited Partnerships Act 1907, and a limited partner should not become involved in the management of the partnership. This may prove to be unduly restrictive for investors looking to actively manage their real estate investments.

Limited partnerships incorporated in Scotland enjoy separate legal personality. This enables them to own property and other assets in their own name, enter into contracts, sue or be sued, borrow money and grant certain types of securities. Limited partnerships incorporated elsewhere in the UK do not enjoy these benefits.

iv Limited liability partnership (LLP)

LLPs are governed by the Limited Liability Partnerships Act 2000 and combine limited liability for members with the tax transparency of a partnership. LLPs are not subject to the same restrictions as limited partnerships, and partners are able to actively manage the business of the LLP. Furthermore, an LLP is a body corporate (having a legal entity separate from that of its members), so there are no issues as to the legitimacy of floating charges. If the LLP is a collective investment scheme, it must be operated by an authorised person in accordance with the Financial Services and Markets Act 2000 (the FSMA).

v Property unit trust

A property unit trust is an open-ended fund that allows pooled investment and is tax efficient. A unit trust is governed by a trust deed, and as such may be an unfamiliar structure to certain overseas investors. One drawback may be the need for authorisation under the FSMA. Offshore unit trusts are popular and can provide further tax advantages as a result of their offshore status; Jersey property unit trusts in particular have been used extensively in recent years. There may still be local regulatory supervision, however, and the fact that the trust must be managed outside the UK may be undesirable for certain investors.

vi Offshore vehicle

Offshore vehicles can take advantage of lighter regulatory and tax regimes. As well as Jersey, popular offshore locations include Luxembourg, Guernsey, the Isle of Man, the British Virgin Islands and the Cayman Islands.

vii Listed property company

Investing in a listed property company offers a popular means of investing in UK real estate. Listed property companies can benefit from a high profile and augmented credibility as well as greater liquidity. The drawbacks include stringent regulatory and filing obligations and a general lack of confidentiality. In addition, listing may be costly and places extra pressure on company management to perform. The investor also has limited control over the underlying real estate assets.

viii Real estate investment trust (REIT)

The REIT is a relatively new form of property-specific investment vehicle in the UK based on an investment structure first developed in the United States. REITs are tax-efficient as they are exempt from tax on income and capital gains; distributions of profits are treated as property income in the hands of the shareholders. To gain REIT status, a company must comply with a number of conditions, including a requirement to be listed on the official list of the London Stock Exchange or traded on a recognised stock exchange, and proof of property rental business characteristics. Recent improvements to the REIT regime aimed at reducing barriers to entry and investment and lowering the costs of compliance have resulted in a significant number of new REITs.

ix Property joint venture

Joint ventures allow parties to share risk and therefore provide a particularly attractive investment structure while the availability of debt remains constricted and investors are keen to mitigate risk exposure in a relatively muted real estate market. A property joint venture can be structured in whatever form the parties choose, and in many cases may involve more than two parties. Of course, as well as sharing risk, parties share gains and management, so joint venture provisions need to be considered carefully.

V REAL ESTATE OWNERSHIP

i Planning

Planning control is used to regulate development and is administered by local authorities, ministers of the Scottish government (and where relevant, the National Park Authorities). New buildings, changes to the use and appearance of existing buildings and other changes to the use of land usually require planning permission, although some minor development does not need consent if it is either inconsequential or uncontroversial, or relates to the existing use of land or buildings.

The planning system consists of:

a development plans, which lay out the ways in which places may change and policies that can be used for planning decisions;

b development management, which is the actual process of making decisions on planning applications, and is directed by the development plan policies; and

c enforcement procedures to ensure that development is completed properly and to ensure that action is taken when development is not completed properly.

Reviews by the Scottish government of both the National Planning Framework, which provides a framework for the spatial development of all of Scotland, and of the Scottish Planning Policy, which states government policy on nationally important land use matters, continue to be ongoing. The Scottish government is also looking at future reforms to the planning system, and simplifying and improving systems and performance to support economic recovery. The emphasis is on non-legislative measures, but legislative changes will be brought forward where necessary. One key aspect on which the Scottish government has consulted during 2013 concerns judicial review, with a proposal that the common law approach in Scotland, which leads to a degree of uncertainty at present, be replaced by a fixed time limit of 12 weeks from the grant of planning permission, within which a referral for judicial review would be competent.

ii Environment

The environmental issue of particular significance to investors is the contaminated land regime, which is set out in Part IIA of the Environmental Protection Act 1990 as amended by the Environment Act 1995. Contaminated land is land that is causing or may cause significant harm to the environment or human health, and the regime also applies to water pollution. There is an obligation on local authorities to inspect their land to identify areas of contamination. Where land is deemed to be contaminated, and is not being remediated voluntarily, the local authority or the Scottish Environment Protection

Agency is obliged to serve a remediation notice on the relevant persons, requiring the clean-up, investigation and monitoring of the contamination. It is a criminal offence to fail to comply with a remediation notice. In general, those who cause or knowingly permit land to become contaminated are responsible in the first instance; however, if no such person can be found, the current owners and occupiers of the site may be liable for remediation costs. While the regulators in the UK do not take enforcement action as readily as in other jurisdictions, remediation costs can be substantial, and it is often necessary to obtain specialist advice when dealing with land that is or may be contaminated.

iii Tax

Value added tax (VAT)

The starting point is that a supply of land will be exempt from VAT. However, the seller or lessor can exercise the option to tax, which will make any sale or letting of the property a supply subject to VAT. The standard rate of VAT is currently 20 per cent. The lessor or seller can then recover the VAT charged on supplies of goods and services made to him or her in connection with the property concerned. In addition, supplies of land are generally subject to VAT if the sale involves a new commercial building completed within the last three years, or an incomplete industrial or commercial building.

Stamp duty land tax (SDLT)

SDLT is a transactional tax payable by the buyer on the acquisition of a chargeable interest and applies to any chargeable consideration payable by the buyer on a relevant transaction. The rate depends on the value of the transaction; the highest rate for non-residential transactions is currently 4 per cent where consideration exceeds £500,000. Residential properties worth more than £1 million are, however, subject to higher rates. SDLT is also payable by the lessee on the rental element of a lease on grant and is charged at 1 per cent of the net present value of the rent payable for the term of the lease. Limited types of transactions are normally exempt from SDLT, including mortgages and personal licences to use or occupy land. There are also a number of reliefs that may apply, including group relief, sale and leaseback relief, acquisition relief, reconstruction relief and charity relief. It is important to consider how best to structure a transaction for SDLT purposes, although the introduction of various anti-avoidance provisions has made it increasingly difficult to implement tax-saving schemes.

The Scotland Act 2012 allows the Scottish government to abolish SDLT and replace it with some other tax on land transactions. The Land and Buildings Transaction Tax (Scotland) Act 2013 was passed by the Scottish parliament in June 2013. This Act contains proposals for a replacement tax that will apply in Scotland from April 2015. Although it will be similar to SDLT in a number of ways, the new land and buildings transaction tax (LBTT) will be a progressive tax, which will be charged only on the proportion of the price within, and at the different rates set for, the relevant band or bands. Rates and bands for LBTT will not be set until shortly before the tax is introduced.

Rates

The occupier of a business property is responsible for the payment of business rates, which fund local government expenditure, and are calculated by reference to the rateable value of the property. Rateable values are assessed every five years, although the next revaluation in Scotland has been postponed from 2015 to 2017, in line with a similar postponement in England and Wales.

From April 2013, local authorities in Scotland had the power to reduce, to 10 per cent, the amount of relief on certain commercial properties that have been lying empty for more than three months. From the same date, new occupiers of shops or offices that have lain empty for at least a year have been entitled to claim a 50 per cent discount on business rates for the first 12 months of occupation.

iv Finance and security

The only way to create a fixed charge over heritable property in Scotland is to grant a standard security. Standard securities were introduced by the Conveyancing and Feudal Reform (Scotland) Act 1970. This Act introduced documents and procedures, including the standard security itself, in a number of variant forms and styles, among which are forms for assignation, restriction, discharge and variation of a standard security.

The 1970 Act also introduced a set of conditions (the standard conditions) that automatically apply to the provisions of any standard security, without the need to refer to them in the document. These relate to practical matters aimed at preserving the value of the property, such as maintenance and repair, alterations and letting of properties, as well as enforcement such as calling-up and notices of default. Most, but not all, can be varied to suit the lender's specific requirements.

The enforcement rights of heritable creditors in the event of default by the borrower are also set out in the 1970 Act.

It is necessary to register a standard security over land at the Registers of Scotland and, if the company giving the security is registered at Companies House, the security must also be registered at Companies House within 21 days of creation. A new regime for the registration of charges created by companies came into force in 2013.

v Title conditions

Title to most real estate in Scotland is affected by title conditions, such as obligations to maintain property (e.g., a boundary wall or fence) or to permit access over land, or restricting the use of land or buildings for particular purposes. The most common types of title conditions are real burdens, which impose an obligation on the owner of the property to do something, refrain from doing something, enter or make use of property, or provide for management of property; and servitudes, which entitle the owner of one property to use another property in some way, such as for access or to lay pipes or for support.

The rules relating to creation, enforcement, variation and termination of such real burdens, formerly governed by common law, made up of case law and custom, are now codified in the Title Conditions (Scotland) Act 2003. Under the previous system it was not always clear who had rights to enforce performance of real burdens, but the requirement under the 2003 Act for dual registration of real burdens against both the burdened and the benefited properties means this is no longer a difficulty for burdens created after 28 November 2004.

Burdens created prior to that date may be subject to rules contained in the 2003 Act that create implied enforcement rights, which can often require extensive title investigations to try to identify benefited owners. Such investigations can occasionally be inconclusive and necessitate other routes being considered, such as title indemnity insurance or an application to the Lands Tribunal of Scotland.

vi Tenement law

Tenement property is a building or part of a building that comprises two related flats that are, or are designed to be, in separate ownership and are divided from each other horizontally. They can consist of entirely commercial property, entirely residential property or a mixture. The law governing ownership and maintenance of common parts of tenements is now governed by the Tenements (Scotland) Act 2004, which introduced a model scheme of management that applies to all tenement properties in Scotland, except to the extent that specific provision is made in the title to the tenement in question. The practical significance of this is that now all existing tenement titles have to be read against the background of the Tenement Management Scheme and the 2004 Act.

The Tenement Management Scheme applies to both existing and new tenement buildings. It provides principally for certain parts of a tenement, such as the roof, foundations, *solum* and external walls to be common parts for the purposes of maintenance and repair, regardless of ownership of these parts. These parts are referred to as scheme property.

VI LEASES OF BUSINESS PREMISES

i Essential elements of leases in Scotland

To be valid in Scotland, a lease must contain four essential elements: the parties, the rent, the premises and the duration. Leases normally have a specified termination date, although it is theoretically possible for a lease to last forever, as there is no rule in Scotland against the creation of perpetuities. Since June 2000, however, there has been a prohibition on the creation of new leases for a period of more than 175 years. There are no restrictions on increasing the rent as long as this is provided for in the lease. Normally this is achieved by setting out rent review provisions in the lease, allowing the landlord to review the rent at certain times throughout the duration of the lease.

In Scotland, a lease is essentially a contract between the parties, and there is very little by way of statutory provision affecting leases, in contrast with the position in England and Wales.

Many commercial leases will be set up on a full repairing and insuring basis (i.e., the tenant is responsible for the costs of all insurance and maintenance and repair of the premises). Provided they make due payment of the rent and observe the other obligations required under the lease, the tenant may not be removed from the premises by the landlord during the period of the lease.

There is no automatic right of renewal for a tenant at the end of the lease, although formal action has to be taken by either the landlord or the tenant to terminate the lease by serving notice to quit, otherwise the lease may continue by a process known as tacit relocation, by which a lease can continue from year to year or, if granted for a duration shorter than one year, that shorter period. The length of time appropriate for a notice to quit to have been effectively served depends on the circumstances, but is usually a period of not less than 40 days.

In very limited circumstances, a statutory right of renewal is available under the Tenancy of Shops (Scotland) Act 1949. This was designed to protect tenants of shop premises by allowing a tenant to apply to the Sheriff Court for renewal of the tenancy where a notice to quit has been served on a tenant that wants to continue the tenancy, but has been unable to get a renewal from the landlord on satisfactory terms.

ii Alienation

In the absence of provision to the contrary in Scotland, on completion of an assignation of a lease, the outgoing tenant (assignor) ceases to have any liability under the lease, and does not remain jointly and severally liable with the new tenant (assignee) or any subsequent assignee. Scottish leases are not subject to authorised guarantee agreements, which are common in England and Wales.

iii Subleases

Unless there is specific provision to the contrary, or a lease is interposed between what then becomes the head landlord and the subtenant, there is no contract between a head landlord and a subtenant. Consequently, if the head lease falls, the subtenant ceases to have any right to occupy. There is no right in Scotland for the subtenant to apply to the court to be granted a direct lease for the residue of the head lease term. Accordingly, a subtenant may seek to obtain a direct undertaking from the head landlord to enter into a new lease, should the head lease terminate.

iv Compensation for improvements

If a tenant has carried out improvements or alterations to leased property, in the absence of provision in the lease, there will be no right to compensation. While the tenant may well be entitled, if not obliged, to remove its trade fittings and fixtures, any fittings and fixtures, improvements and alterations that are of a permanent nature may be deemed to have become part of the landlord's property. The landlord will normally seek to have the option to have the property reinstated or left with such additions without any compensation being due.

v Termination on destruction or abatement of rent

In the event of material damage to or destruction of the property, and in the absence of contractual provisions being incorporated in the lease excluding the common law, a lease will terminate as a consequence of the principle of *rei interitus*. Common law would also entitle an appropriate abatement of rent in the case of partial damage. However, most commercial leases provide for continuation notwithstanding damage or destruction, although it is common to find provision that, in the event of the property not being reinstated within a specific period (usually calculated by reference to the period of loss of rent insurance cover), either party would have the right to terminate.

VII DEVELOPMENTS IN PRACTICE

i Scottish parliament and land law reform

Domestic legislation in Scotland has been the responsibility of the Scottish parliament since 1999, when powers were devolved from the UK government in Westminster. Westminster retains legislative responsibility for reserved matters, including corporate law, economic, monetary and most fiscal policy, competition, transport and energy. Limited fiscal powers are devolved to the Scottish parliament. We outline up-and-coming changes of interest to the real estate sector below.

Since 1999, there have been a number of fundamental changes to Scottish real estate law enacted by the Scottish parliament. Developments in competition and energy law enacted by the UK parliament also affect Scottish property interests.

One of the key changes to Scottish property law in recent years was the abolition in 2004 of the feudal system of landholding, seen as increasingly anachronistic in modern society. Under this system, land was held and occupied by vassals under a feudal superior to whom the vassal owed duties such as performance of obligations (e.g., erecting buildings) or the requirement to pay regular sums of money known as feu duty. Prior to abolition, feudal superiors had the opportunity to reallocate enforcement rights in respect of feudal conditions onto other property owned by them, with the result that although the feudal relationship of superior and vassal has disappeared, many formerly feudal title conditions are still in existence. The right to claim payment of feu duties has now expired.

ii Land reform

The Scottish parliament has, from its inception, pursued a vigorous programme of land reform. A flagship policy of the parliament was the transformation of public rights of access by Part 1 of the Land Reform (Scotland) Act 2003, which extended statutory access rights to everyone to encompass the right to be on land (including inland waters, canals and the foreshore) for recreational purposes, or carrying on a relevant educational activity, or carrying on a commercial activity, provided it is an activity that is capable of being carried on uncommercially; and the right to cross land.

Access rights must be exercised responsibly, and there is power to exclude or restrict land from the exercise of access rights (e.g., for the purposes of defence or national security). Also excluded is 'sufficient adjacent land' next to a house so that the occupants of the house can have a reasonable amount of privacy. This will normally mean the garden around a house.

A Land Reform Review Group formed by the Scottish government commenced a radical review of land reform in Scotland, producing an interim report in May 2013. This followed several months of gathering evidence and information on land reform issues, in particular how the rights created by the 2003 Act are operating in practice, and consideration of how the benefits of community ownership could be extended to more communities. A final report is expected to be submitted to government ministers by April 2014.

iii Annual tax on enveloped dwellings (ATED)

The Finance Act 2013 introduced the new ATED. It applies where a residential property with a value of more than £2 million is held by a non-natural person, such as a company, partnership where a partner is a company or collective investment scheme. The annual charge ranges from £15,000 to £140,000 and depends on the value of the property. A number of reliefs are available, including where the property is held as part of a property rental business or by a company carrying out a property development trade or buying and selling properties as a trade. ATED forms part of a package of measures aimed at dissuading individuals from acquiring residential properties through special purpose vehicles, and is in addition to the 15 per cent SDLT rate that applies where a high value residential property is acquired by such a vehicle. Purchasers will need to balance the privacy and tax advantages associated with using a corporate wrapper against the onerous SDLT and ATED liabilities.

When SDLT is replaced with LBTT in Scotland in 2015, it is expected that ATED will cease to apply as well.

iv Energy performance certificates (EPCs)

An EPC for a building states the energy efficiency of that building and provides carbon dioxide ratings in bandings from A to G, similar to energy ratings for domestic appliances. The EPC also includes recommendations for the cost-effective improvement of the energy performance of the building, but these are not mandatory. EPCs are required for new buildings in Scotland under building regulations, which provide that an EPC is to be a fixture within a building.

Existing buildings in Scotland are governed by the Energy Performance of Buildings (Scotland) Regulations 2008 (as amended by the Energy Performance of Buildings (Scotland) Amendment Regulations, Amendment No. 2 Regulations and Amendment No. 3 Regulations 2012), which require that when the building is to be sold or let, the owner of the building must make a copy of a valid EPC available, free of charge, to a prospective buyer or a prospective tenant.

An EPC must be accompanied by a recommendations report. This must include more detailed information on the cost-effectiveness of recommendations made in the EPC and steps to be taken to implement those recommendations. Recommendations for improving energy efficiency contained in the EPC must be not only cost-effective but also technically feasible.

Property advertisements must include the energy performance indicator of the EPC. Only the A–G performance indicator given on the EPC is to be stated in such advertisements in commercial media, which includes any particulars advertising a property for sale or rent in electronic or hard-copy format.

EPCs have to be issued and displayed in buildings larger than 500 square metres that are occupied by a public authority and are frequently visited by the public. This threshold will reduce to 250 square metres on 9 July 2015.

EPCs have to be displayed in commercial premises larger than 500 square metres that are frequently visited by the public and where an EPC has already been issued. Buildings that are frequently visited by the public means, in broad terms, buildings that are visited by the general public at least weekly, and will include non-domestic buildings where access to all or part of the building by members of the public is integral to the daily operation of the building and where members of the public would expect to be able to enter, such as shops, cinemas and health centres.

v Carbon reduction

The Carbon Reduction Commitment Energy Efficiency Scheme (the CRC) aims to improve energy efficiency and cut emissions in large businesses and public-sector organisations with significant electricity use. UK government plans to simplify the CRC were enacted in the CRC Energy Efficiency Scheme Order 2013 on 20 May 2013, which is intended to reduce complexity and result in a significant reduction in administrative costs. The majority of the proposals in the Order will be introduced at the start of the second phase of the CRC in 2014/2015. The overall effectiveness of the scheme will be reviewed in 2016.

vi Tenants and insolvency

Despite improvements in the economy, the struggling retail sector continues to be plagued by a succession of high-profile tenant failures. High street casualties in 2013 have included Blockbuster's UK arm, Barratts Shoes and HMV, and reports indicate that a significant number of retailers remain at risk of insolvency.

A number of landlords affected by the administration of the Game group of companies in 2012 have lodged an appeal with the Court of Appeal that seeks to overturn the principles in the English cases of *Leisure (Norwich) II Ltd and others v. Luminar Lava Ignite Ltd (in administration) and others*[2] and *Goldacre (Offices) Ltd v. Nortel Networks UK Limited (in administration)* (see the England & Wales chapter, Section VII.v).

These cases, concerning, respectively, the rental liability of administrators and a landlord's right to forfeit the lease, may have persuasive (although not binding) effect in Scotland.

VIII OUTLOOK AND CONCLUSIONS

i The Scotland Act 2012

The Scotland Act 2012 provides for the transfer of certain tax and borrowing powers from the UK parliament to the Scottish parliament, although not to the extent of giving Scotland financial independence. Currently, the Scottish parliament raises around 15 per cent of its own budget, and with the new arrangements this is expected to increase to about 35 per cent.

The main financial proposals are as follows:

a a Scottish income tax will replace part of the UK income tax;
b SDLT and landfill tax will cease to apply, and the Scottish parliament will set levels of tax for land transactions and disposals to landfill for Scotland (see Section V, *supra*);

2 [2012] EWHC 951 (Ch).

c other taxes may be created or transferred to the Scottish parliament; and
d significant new borrowing powers will be available.

The new taxation powers in the Scotland Act 2012 are general enabling provisions. The precise detail and arrangements for implementation will be set out in future secondary legislation.

Fiscal changes are the main proposals in the Scotland Act 2012. A number of other areas will be affected, allowing for greater devolution in some cases and a return to UK legislative responsibility in others.

On 18 September 2014, the people of Scotland will vote in a referendum on whether Scotland should be an independent country. Dependent on the outcome of that vote are a number of key issues, including matters of financial and other regulation, currency, and EU and NATO membership. It should be recognised, however, that constitutional reform in Scotland is largely concerned with changing who is responsible (and accountable) for Scotland's legal and regulatory framework, not with changing the substantive terms of that framework.

ii Reform of the land registration system

The Land Registration etc. (Scotland) Act 2012 will overhaul and improve the current system of registration of title to land. Highlights are the introduction of an advance notice system that will protect purchasers and security holders, and provisions enabling electronic conveyancing. The provisions relating to electronic conveyancing are due to come into force in early 2014, with the remainder of the Act expected to come into force in late autumn of 2014.

iii Conversion of long leases

The Long Leases (Scotland) Act 2012 provides for the conversion of ultra-long leases into ownership. An ultra-long lease is one that has a duration of more than 175 years, and still has more than 100 years left to run in the case of residential leases, or 175 years left to run in the case of non-residential leases. To qualify for the conversion provisions, the rent payable under the lease must be no more than £100 per annum. The provisions will allow some leasehold conditions to become real burdens in the title deeds of the property enforceable by the former landlords. There are also provisions for compensation and additional payments to be paid to landlords. Landlords will also be allowed to preserve sporting rights in relation to game and fishing.

These proposals will come into force on 28 November 2015.

iv Climate change

Property and buildings are affected by many regulatory requirements for carbon emissions reduction. The carbon footprint of buildings is the source of around 50 per cent of greenhouse gas emissions in the UK. Consequently, real estate is subject to increasing regulation, such as EPCs, in efforts to improve the energy efficiency of buildings and reduce emissions.

Complementing the UK Climate Change Act 2008 is the Climate Change (Scotland) Act 2009, which sets a challenging interim emissions reduction target of 42 per cent for Scotland by 2020.

One of the key proposals for achieving this target is the introduction of a process for assessment of the carbon and energy performance of a building, known as an assessment of the carbon and energy performance (ACEP). Owners of non-domestic buildings with a floor area of more than 1,000 square metres will be required to carry out an assessment of the energy performance of their buildings, and the emission of greenhouse gases produced by those buildings or by activities carried on within them, and then take steps to improve energy performance and reduce emissions.

An ACEP will need to be conducted on sale or rental of a qualifying building, and will consist of three elements: an EPC, a recommendations report and an action plan.

Once the components of the ACEP have been obtained, the owners of the property can either carry out the improvement works to the building that the ACEP recommends, or opt to measure and report on the operational ratings of the building and display a certificate of those operational ratings within the building. The Regulation implementing the ACEP will be integrated with existing Scottish EPC Regulations. These new Regulations are expected to be introduced during 2014, but no date for their introduction has been set.

v Green Deal

The Green Deal is the flagship provision of the Energy Act 2011, and has been available from 28 January 2013. It is a framework that allows private organisations to offer consumers – homeowners and businesses – energy efficiency improvements to their property at no up front cost, and recover payment by way of instalments through a charge on the consumer's energy bill. This financial obligation stays with the property and whoever is the bill payer from time to time. The concept underlying the framework is that the costs of improvements should be offset by the energy savings that such improvements will bring, resulting in lower energy bills.

In the year since its introduction, take up of the Green Deal has been disappointing, prompting the UK Department of Energy and Climate Change to announce measures to make it easier for people to participate. Initially, the Green Deal has only been available for domestic property in the UK.

Chapter 31

SLOVAKIA

Tomáš Zárecký[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

Legal regulations governing ownership of real estate – its forms as well as methods of acquisition – comprise especially the Slovak Civil Code,[2] the Real Estate Cadastre Act,[3] the Flats Ownership Act,[4] the Act on Protection and Use of Agricultural Soil[5] and the Building Act.[6] Generally, real estate is defined as plots of land and permanent structures connected to the land with fixed foundations.

Unlike in some jurisdictions, the principle of *superficies solo cedit* is not applicable in Slovakia, which means that the owner of a plot of land and the owner of a construction built on it may be two different persons. In addition, if the owner of the plot of land and the building erected on it is the same person, such owner may separately transfer the ownership title to the plot of land and to the construction to two (or even more, in the case of co-ownership) different acquirers. If a person builds a construction on a plot of land of a third party without a due title, court may decide, based on a petition of the landowner, that such illegal construction be removed at the cost of constructor. If, however, such removal is proved to be not useful and impractical, the court will decide on the transfer of the ownership title to the construction to the landowner against compensation, subject to the landowner's approval. Finally, the court may also settle

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2 Act No. 40/1964 Coll.

3 Act No. 162/1995 Coll.

4 Act No. 182/1993 Coll.

5 Act No. 220/2004 Coll.

6 Act No. 50/1976 Coll.

ownership relations between the owner of a construction and the landowner differently: it may especially establish an encumbrance against consideration in favour of the construction owner required for the performance of the ownership right towards the construction.

Just one type of ownership exists in Slovakia, meaning that the owner, irrespective of his or her nature, is entitled to possess, enjoy, use the benefits of and freely dispose of the object of ownership. The same real estate may be owned by two or more co-owners (which is quite common in Slovakia). There are two forms of co-ownership: co-ownership by shares and undivided co-ownership (with no shares) (the latter can only be formed between spouses). As regards dealing with co-owned real estate (including its sale to an investor), the co-owners decide thereon by simple majority calculated on the basis of the size of their co-ownership shares. In the event of equal votes or in cases where a majority is not reached, each of the co-owners may apply to the court to decide in the respective matter on how to deal with such real estate. In the case of a significant change affecting co-owned real estate, outvoted co-owners are entitled to apply to the court to decide differently in the respective matter.

Ownership title to real estate may be acquired by contracts on its transfer (whether purchase contract or deed of gift), inheritance, court decision, under special regime in execution proceedings, by usucaption (adverse prescription) or under other circumstances set out by generally binding legal regulations. A legitimate possessor of real estate may become its due owner provided such person has in good faith, as regards the existence of his or her ownership title to the real estate, continuously possessed such real estate and acted as its owner at least for 10 years. This time period covers also the time period during which the respective real estate was possessed in good faith by other potential predecessors.

A special regime is applicable to the ownership of flats and its transfer, regulated by the Flats Ownership Act. Owners of flats in a residential building are not co-owners of the residential building as such, while each of them is the individual owner of a respective flat (or flats) to which are attached, by virtue of law, a co-ownership share of common parts, equipment and appurtenances of the residential building, a co-ownership share of the plot of land upon which the residential building is built, and a co-ownership share of the adjacent plot of land (these aspects must be assessed by an investor who may wish to acquire such residential building with the aim of refurbishing it, for example, into a hotel or boarding accommodation house).

ii System of registration

Rights to real estate, including ownership titles, mortgages, encumbrances, *in rem* pre-emption rights, rights resulting from the administration of state or municipal property and rights resulting from lease of plots of land exceeding five years, are evidenced in the real estate cadastres kept by district offices as local bodies of state administration covering the territory of a particular district. Generally, rights to real estate are established, changed or terminated upon effective registration (intabulation) by the territorially competent district office (its real estate cadastre department). Owners are obliged to ensure that all cadastral data concerning the real estate and its owner, including changes of such data, be duly registered with the real estate cadastre, and to notify the district office of any change within 30 days following the occurrence, change or termination of the relevant decisive fact.

Ownership title to be transferred under a real estate purchase agreement is acquired by the purchaser only upon the effective decision of the real estate cadastre on its registration. Effective registration thus has constitutive effects. Application for the registration of title transfer is filed by parties to the respective purchase agreement, while the real estate cadastre decides thereon within 30 days (for a fee of €66, or €33 if the application is submitted electronically) or within 15 days (for a fee of €266). The above fees represent lump-sum amounts and do not depend on the value of the transferred assets. Signature of the transferor on the real estate transfer agreement must be officially verified. Since there always is a certain time period between execution of the ownership title transfer agreement and its actual effective acquisition by the purchaser, escrow agents (be they a notary public or a bank) are frequently involved in real estate transactions in Slovakia, especially to administer the purchase price before acquisition of the ownership title.

According to the Real Estate Cadastre Act, data on rights to real estate (including ownership title) evidenced by the respective real estate cadastre are considered as binding and trustworthy, unless it is proved otherwise. Therefore, there is no state guarantee as regards the existence of title with respect to registered data. It is always recommended to perform a title due diligence dating back at least 10 years, and to duly inspect all acquisition titles within such time period. It is also not uncommon in Slovakia, especially when certain doubts have arisen during the due diligence process, to opt for title insurance coverage.

iii Choice of law

Parties to an agreement concerning real estate must not deviate from the mandatory provisions of Slovak law regulating the transfer of title or establishment of a mortgage or encumbrance over real estate, including related procedural aspects. A real estate transaction may also be structured in such a way that the contract dealing with its various details is governed by a foreign law, while the actual transfer instrument (forming, for example, its annex filed separately for registration) follows the mandatory provisions of Slovak law.

II OVERVIEW OF REAL ESTATE ACTIVITY

The office market saw the delivery of 58,000 square metres of office space in 2012, compared with 66,000 square metres in 2011. The majority of leasing activity is still driven by existing tenants seeking expansion options and a combination of better space and lease terms, rather than newcomers. Rents in Bratislava were already at or close to their bottom rate in 2013, placing Bratislava in the lowest-ranking position of all central and eastern European markets with respect to net effective rent, at €13.5 square metres a month. Several contemplated schemes remain postponed due to challenging market conditions. As regards the industrial market, Slovakia is one of the top three most active locations in central and eastern Europe (together with Poland and the Czech Republic) in relation to size. This is mostly due to the fact that locations in Slovakia continue to be driven by demand for space with proximity to Germany and Austria from regional manufacturers, distributors and retailers. Leasing and development activity in the industrial and logistics sector continued to grow in industrial centres outside the capital. The Slovak industrial market retains the potential to deliver logistics parks comprising high quality and divisible space during 2014. Several retail projects opened across Slovakia in 2012, offering an additional 20,000 square metres in the central towns of Banská Bystrica and Zvolen, and 55,000 square metres in the capital. Food retailers continue to expand to virtually all parts of Slovakia, some of them concentrating also on smaller, more centrally located concepts, such as Tesco Express. Rental numbers fell in Bratislava (-15.8 per cent in 2012) because the retail market has reached an interim level of saturation. The shopping centre stock per capita reached 700 square metres, which is double the European average. In this connection it must be noted that Bratislava, on the other hand, does not have a sufficiently developed traditional high street market, thus allowing for greater shopping centre capacity. The growth forecast for the Slovak retail market over the next three years is predicted at 25 per cent.[7]

As regards external financing, it can be concluded that Slovak banks generally performed well in 2013 and were not dangerously caught up in bad loans. On the other hand, due to the small size of the Slovak market and the fact that Slovak banks are mostly subsidiaries or branches of foreign banks, they are not able to individually finance more demanding projects in terms of financing. There are, however, signs that Slovak banks have available funds and are willing to finance quality small to medium-sized projects. Foreign banks (usually providing syndicated loans) appeared as creditors financing infrastructure or energy projects rather than the acquisition of single assets, especially due to decreasing yields and values of properties compared with those prior to 2009.

III FOREIGN INVESTMENT

Any foreign corporate entity or natural person may freely acquire real estate in Slovakia, with a minor exception concerning agricultural land located beyond the built-up area of municipality and with the exception of forests. Such exempted agricultural land and forests may, however, be acquired by a foreigner through inheritance, or by a foreign national who is a citizen of an EU Member State with respect to soil on which the foreign person has performed an economic activity for at least three years following 1 May 2004.

The above-mentioned restriction is expected to end in 2014. In any case, any foreign person affected by such restriction may legally avoid it by incorporating a Slovak subsidiary and acquiring such real estate through this vehicle.

IV STRUCTURING THE INVESTMENT

Real estate investments are traditionally structured either as a direct asset deal or as a share deal using a special purpose vehicle, which in the majority of cases is a limited

7 This paragraph is based on the Research and Forecast Snapshot 2013 Eastern Europe, Colliers International.

liability company that is the beneficial owner of the targeted asset. Investors mostly assess the following criteria in order to choose which way to proceed:

a the applicability of real estate transfer tax;
b restrictions on acquiring real estate;
c risks associated with the change of control provision;
d preferable tax treatment at the final stage of sale of the respective property or company, as well as other tax optimisation issues;
e the stage of the development–sale circle of the property at which the investor enters into the transaction;
f demands for a due diligence process; and
g other specific issues.

It could generally be concluded that in the early development stages in the life of a commercial property, investors tend to acquire plots of land for the purposes of their future development into commercial property as an asset deal. This is mostly due to the fact that ownership of land is usually divided among a number of owners (co-owners); as such, the developer must deal individually with each owner to gain a uniform plot of land suitable for development, and it would be impractical to set up a special purpose vehicle for each individual case. This approach is further supported by the fact that since 1 January 2005, no real estate transfer tax is applicable in Slovakia.

In the next phase, when the developer (also most commonly having the legal form of a limited liability company) manages to lease a commercial property and make it ready for sale, investors prefer to acquire the company owning the asset rather than the asset itself. One reason for this is a general provision in the Civil Code, according to which if the ownership title to real estate is changed, the tenant may for this reason terminate the existing lease contract upon notice, even if such lease contract is concluded for a definite period of time. Notice of termination must, however, be served in the termination notice period set out by law or agreed in the lease contract. Although this provision has not yet led in practice to any significant disputes, investors prefer to avoid potential risks by opting for a share deal structure. A second reason is connected with the taxing of profits on income generated by a transfer of real estate and shares. Foreign corporate investors are usually treated as taxable persons with limited tax liability, while any profit (generally calculated as the positive balance between the sale and acquisition price) generated from the transfer or other use of real estate located on the territory of Slovakia will be subject to income tax at a rate of 23 per cent. On the other hand, a sale of shares in a Slovak company owning commercial property is not subject to Slovak income tax, provided the shares are sold to a foreign company. Of course, provisions of respective international treaties on the avoidance of double taxation to which Slovakia is a party must also be consulted.

V REAL ESTATE OWNERSHIP

i Planning

Detailed legal regulation of various aspects concerning territorial planning, construction activity, occupation proceedings, change of completed construction and change of its use, as well as other related issues, is contained in the Building Act. The competence of the construction authority is vested in the municipalities, with the exception of certain specific construction activities, for example the construction of highways, in which case the Ministry of Transport, Construction and Regional Development of the Slovak Republic acts as the construction authority.

Generally, a developer must obtain the effective territorial decision issued by the construction authority prior to the contemplated development. The territorial decision:

a determines the respective area for development purposes;

b deals with objections of other participants to the territorial proceedings (mostly neighbours and other affected natural and legal persons);

c issues conditions to protect the public interest, environment and architectonic values; and

d sets out conditions for compliance with the zoning plan of the municipality.

Municipalities with over 2,000 inhabitants must elaborate their respective zoning plan, which, *inter alia*, sets forth permitted, limited and prohibited uses of territory, rules of functional use of territory (e.g., the minimum percentage of a given area to be dedicated to greenery and the maximum percentage of such area to be used for construction) and rules to deal with transportation issues. Developers should obtain territorial planning information from the respective municipality and ensure that their project complies with requisites prescribed by the municipal zoning plan.

Construction activity may commence on the basis of an effective construction permit issued by the construction authority. The construction authority decides therein on binding conditions for erecting the building and for its use, and shall also deal with objections of participants to the construction proceedings. The binding conditions are intended to protect the public interest and ensure compliance with the general technical requisites and technical norms for construction, as well as with conditions determined by other affected bodies. Generally, the construction permit shall become null and void if the construction works permitted under it do not commence at the latest within two years from the date of its effectiveness. The construction authority may, in justified cases and upon a petition filed by the constructor, decide on a change of the building prior to its completion. In the case of a positive decision, the construction authority shall also deal with any objections of affected persons, and will state in the amended building permit binding conditions for completing the changed project.

The completed building may be used strictly on the basis of an effective occupancy permit issued by the construction authority. The building may be used only for the purpose specified in the occupancy permit, and any change in the use of the building requires the effective decision of the construction authority.

ii Environment

The Act on Certain Measures in the Area of Environmental Burdens[8] adopted in October 2011 regulates, *inter alia*, the process of identifying environmental burden (including contaminated land), obligations of the polluter as well as rules for determining the

8 Act No. 409/2011 Coll.

responsible person in cases where the polluter does not exist. Polluter is defined as any person that has caused an environmental burden through his or her activity. The polluter is obliged to elaborate and carry out his or her plan to remove the environmental burden. If the polluter fails to carry the plan out, the competent supervisory authority may impose a fine of up to €33,000.

If the polluter has ceased to exist, the Act on Certain Measures in the Area of Environmental Burdens regulates in detail rules and procedures to determine the responsible person instead of the polluter. If specific conditions are fulfilled, the regional environmental office will determine the polluter's legal successor as the responsible person; if such legal successor does not exist, it will determine the owner of the contaminated real estate as the responsible person.

The polluter or the responsible person may transfer land affected by an environmental burden only after it has procured a geological exploration of the contaminated land. The report on such geological exploration must be attached to the agreement on the transfer of ownership title to such contaminated land.

iii Tax

Currently, no real estate transfer tax is applicable in Slovakia, since it was abolished with effect from 1 January 2005. Therefore, there is no need to elaborate an expert's appraisal to determine the purchase price, while the seller and purchaser may freely agree on its amount. Transaction costs are also kept low due to the fact that the stamp duty payable at the registration of ownership title does not depend on the price of the transferred real estate (the stamp duty amounts to €266 if the cadastre office registers the title in an accelerated proceeding within 15 days from delivery of the application to register).

Supply of land that is not classified as construction land is VAT exempt. Generally, the construction and the related construction land are VAT exempt if their transfer is effectuated at least five years following an effectiveness of occupancy permit proving due completion of such construction.

iv Finance and security

Currently, there are no thin capitalisation rules applicable in Slovakia, and there are also no limitations on financing real estate with equity. Almost every transaction concerning real estate relies on external financing, most frequently provided by banks.

The most common form of security instrument granted over real estate is a mortgage established in favour of the creditor (usually a bank financing acquisition of the respective real estate charged by the mortgage). A mortgage over real estate is established under a written mortgage agreement that specifies the mortgaged asset, secured receivable and value of the secured receivable (or at least the highest value of the principle secured by the mortgaged asset). The mortgage becomes effective upon its registration in the real estate cadastre.

Other security instruments protecting the creditor in real estate transactions comprise the establishment of:

a a pledge over funds in the debtor's (purchaser's) bank account, or over his or her receivables for payments of rent from his or her tenants or from insurance proceeds; or *b* a pledge over the shareholder's stake in the debtor's company, or a notarial deed on the direct enforceability of the creditor's right for repayment of the loan with appurtenances.

Such notarial deed will enable the creditor, in the event of a breach of the loan agreement by the debtor, to enforce (sell) the mortgaged asset directly through execution proceedings without the need to first go through litigation proceedings concerning repayment of the loan.

VI LEASES OF BUSINESS PREMISES

Certain mandatory aspects of the lease and sub-lease of business premises are regulated by the Act on Lease and Sub-Lease of Non-Residential Premises[9] and by the Civil Code.

For a commercial lease contract to be valid, it must be concluded in written form and must specify the subject and purpose of the lease, the amount, maturity and manner of payment of the rent, and the term, unless concluded for an indefinite period.

Landlords and tenants are free to agree on the lease duration as they wish. The Act on Lease and Sub-Lease of Non-Residential Premises distinguishes between definite and indefinite term of lease. The main difference is that a lease concluded for an indefinite period of time may be terminated by any party and without any reason. The termination notice period is three months in such case, unless agreed otherwise. In the case of premature termination of a lease concluded for a definite time period, certain mandatory rules must be followed. A catalogue of reasons for such premature termination sets out specific breaches of the lease by the tenant (e.g., delay in payment of rent exceeding one month or subleasing the business premises without landlord's consent) as well as the landlord (e.g., his or her failure to maintain the subject of the lease in a state proper for the agreed use). According to prevailing legal opinion, reasons for premature termination of business premises set out by law may not be eliminated; however, the landlord and tenant may agree on their expansion.

The amount of rent reflects the current market situation and depends solely on the agreement of the parties. There is no obligation to increase the rent; however, it is very common that the rent is indexed and increased on a yearly basis. The most typical indices are the flat index (e.g., an increase of 3 per cent per year), inflation or the EU Harmonised Index of Consumer Prices. Apart from paying the rent, the tenant is obliged to separately pay to the landlord service charges connected with the lease. It is always upon the parties to agree clearly and in detail what charges are payable by the tenant (e.g., water and electricity consumption or security service) and which services are excluded from the payment of service charges (e.g., a portion of the real estate tax paid by the landlord as the owner of the whole property attributable to the premises leased out to a given tenant). However, this always depends on particularities of each individual lease and the agreement of the parties, taking into account also incentives the landlord wishes to provide to particular tenant. To procure the due and timely payment of the tenant's

9 Act No. 116/1990 Coll.

monetary obligations under the lease contract (i.e., to pay the rent, service charges as well as potential contractual penalties or compensation of damage), parties frequently agree on the implementation of the tenant's obligation to provide to the landlord a bank deposit or a bank guarantee (usually up to an amount equal to six months' rent), or a parent company guarantee. A combination of these measures also occasionally takes place.

As regards the change of control provision under Slovak law, according to the Civil Code, if the ownership title to real estate is changed, the tenant is entitled to terminate the lease contract for this reason, even if such lease contract has been concluded for a definite period of time. As a matter of fact, investors prefer to use a share deal structure in a real estate transaction in order to prevent potential risks connected with this outdated norm.

VII DEVELOPMENTS IN PRACTICE

i Rights to land forming a construction site in infrastructure projects

On 28 October 2011, the first ever Slovak PPP infrastructure project was launched, comprising three sections of a new, 46 kilometre expressway in central Slovakia. Works on this project illustrated once more that one of the crucial factors for construction projects in Slovakia is the due and proper acquisition of ownership rights (or other rights entitling parties to construct, as prescribed under the Building Act) to the affected plots of land by the investor (in the case of highways and expressways, this would be the state). As a general rule, in the case of construction activity, documents proving ownership title or other rights must be submitted to the construction authority at the time of applying for the construction permit. It is always administratively demanding and time-consuming to establish a settled construction site in terms of ownership relations, and to obtain documents proving formation of such site. The Act on Extraordinary Measures for Preparation of Certain Construction of Highways and Roads for Motor Vehicles[10] was adopted in December 2007 to facilitate the construction of highways and expressways in Slovakia. According to its original version, should the constructor of a highway be unable to submit evidence to the construction authority proving its ownership or other rights to the site, it may instead submit at least evidence of the intention to obtain those rights or of the impossibility of obtaining them (e.g., evidence on pending inheritance proceedings). Evidence of ownership or other rights would have to be submitted only during occupation proceedings, once the highway is constructed. The concept that construction activities could be permitted on the land of a third person without legal title has been considered by many to be unconstitutional. As a result, on 26 January 2011, the Constitutional Court held that these provisions in relation to construction activities on the land of another are in breach of the Slovak Constitution. The Constitutional Court identified that situations where a constructor may build road infrastructure and even launch such into preliminary operation without the consent of the owner of the affected

10 Act No. 669/2007 Coll.

land establishes an unconstitutional limitation of ownership title, and represents *de facto* a method of illegal expropriation.

ii Increased income tax and VAT

With effect from 1 January 2013, the left-wing government abolished the flat tax rate, under which corporate income tax, individuals income tax and VAT all had the same rate of 19 per cent. Corporate tax has been increased to 23 per cent, income tax of individuals earning more than €34,401.74 per year has been increased to 25 per cent, while VAT grew by 1 per cent to 20 per cent. This combination may have a minor negative impact, especially on the retail industry, since increased personal taxes are expected to slightly influence retail spending and the increase in corporate taxes will affect the performance of tenants in shopping centres, as well as developers and owners of shopping centres as such. In addition, the increase in corporate income tax will reduce returns from investment in any commercial property.

iii Amendment to the Act on Certain Measures Concerning the Preparation of Significant Investments[11]

The Act on Certain Measures Concerning the Preparation of Significant Investments regulates the simplification of settlement of ownership relations necessary for the preparation of construction activity classified as significant investment. According to an amendment adopted with effect from 1 August 2013, significant investment shall be considered, *inter alia*, as an investment in a construction whose building costs exceed €100 million, whose realisation will generate at least 300 new working positions and, in respect of which the government will decide in a specific procedure, that its completion is in the public interest. A project recognised as a significant investment will further represent one of the specified purposes under the Building Act for which expropriation of land and buildings is permitted in the pulic interest. As a result, this amendment is expected to facilitate the construction and development of several significant investment projects, especially in the fields of leisure, the hotel and convention centres industry and entertainment.

VIII OUTLOOK AND CONCLUSIONS

A completely new building code is expected to replace the current Building Act (adopted in 1976 and amended over 30 times since then) with effect from July 2014. Some of the main aims are to modernise territorial and construction proceedings, shorten and simplify the administrative procedure connected with permitting constructions, and to set out deadlines for affected state administration bodies to issue their standpoints regarding contemplated construction activities. This recodification will also bring about a new classification of constructions, comprising constructions not requiring any permit, constructions to be permitted upon notification to the construction authority (e.g., residential houses with a built-up area not exceeding 300 square metres), constructions

11 Act No. 175/1999 Coll.

to be permitted in accelerated construction proceedings, constructions to be permitted in standard construction proceedings and constructions to be permitted in stricter proceedings.

One of the main focuses of the contemplated new building code is to prevent the occurrence of illegal constructions (i.e., buildings under construction or erected without an effective construction permit). Under established practice, the construction of buildings that were under construction illegally was approved by the institution of a supplementary approval of construction. Under the proposed new legislation, the construction authority will be obliged to issue a decision binding the developer to terminate construction works on illegal constructions. Such decision will be delivered to the construction company as well as to the owners of water and electricity infrastructure providing respective utilities to the construction site, and they will be obliged to immediately terminate the delivery of such utilities. As a second step, the construction authority will instruct the developer to remove the illegal construction at its own cost within a determined time period. If the developer does not comply with such instruction, the construction authority will so instruct the construction company, while the costs of the illegal construction removal will be borne by the developer. As such, it will no longer be possible to legalise an illegal construction.

Unlike the current Building Act, the contemplated new building code will not regulate the expropriation of real estate; this procedure and its detailed rules are to be dealt with in a new act on expropriation of plots of land and buildings.

Finally, a high level of activity is expected in 2014 in the EU-backed construction of road infrastructure. 2014 should also be the peak year as regards the volume of highways and expressways under construction in Slovakia.

Chapter 32

SOUTH AFRICA

Andrew Bembridge[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

Title to real property in South Africa vests in the landowner, in that land may be freely owned by any persons wishing to do so. There is a comprehensive legal framework in South Africa for the ownership and transfer of real estate, through common law that is underpinned by statute.

South Africa has an efficient system of registration of title to land, based on a land survey system. Each portion of land is determined by a diagram prepared by a surveyor and registered in the Surveyor General's Office. This gives rise to a certain and definite basis of registration of land.

Property registers have been established in the various deeds registries within the different provinces of South Africa. Those registers are properly indexed and the records are accessible electronically, the originals of title deeds and other documentation having been digitised. The deeds registries are established under the relevant government department, and all fall under a Chief Registrar of Deeds.

Given the definite underlying survey system, the property registers are very accurate. All ownership of land is recorded in a deeds registry.

Ownership of land is evidenced by a title deed issued by the deeds registry, which will record the owner's details and the conditions under which the land is held. These conditions are normally imposed by local authorities and by private agreement.

If a particular ownership is not registered in a deeds registry, it is most likely that that ownership of the property has not passed. Transfer of ownership of property is evidenced by registration in a deeds registry.

The law applicable to the transfer and registration of land is, in the first instance, the Deeds Registries Act 47 of 1937, together with its regulations. There are a number

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of other statutes that govern the ownership and transfer of land, but in essence, there is no restriction on ownership of land in South Africa, and any natural person or juristic person may own land.

It is possible to own units in buildings through the Sectional Titles Act 95 of 1986. These are known as sectional title units, and are registered in a deeds registry, by reference to a sectional title plan, prepared by a surveyor registered with the Surveyor General.

Property rights are protected in the Constitution of South Africa 1996. The Bill of Rights in the Constitution restricts the deprivation of property, except in the case of expropriation in terms of a law of general application, which must then be subject to compensation, which in turn must be agreed by the affected persons or approved by a court. That compensation must be just and equitable, and generally requires that regard be given to the fair-value principle.

There is a process of restitution to persons dispossessed of land through racially discriminatory laws, which is governed by the Restitution of Land Rights Act 22 of 1994.

II OVERVIEW OF REAL ESTATE ACTIVITY

As has the rest of the world, South Africa has been affected by the recent worldwide recession, resulting in a downturn in the property market that has had an effect on prices and activity in the real estate market. There are signs of recovery in the market.

The National Credit Act 34 of 2005 became law on 1 June 2006, and is a comprehensive piece of legislation regulating the granting of credit to consumers. Its purpose is to protect consumers and regulate credit providers. This Act regulates consumer credit, promotes responsible credit granting and prohibits reckless granting of credit.

The National Credit Act has had a marked effect on real estate activity in South Africa, as credit is not easily available to consumers.

In addition to the National Credit Act, the Consumer Protection Act 68 of 2008 came into force on 31 March 2011. That Act promotes a fair, accessible and sustainable marketplace for consumer products and services. It protects consumers against certain suppliers of services (i.e., developers) in the property sector and other industries. The intention of the Act is also to promote the economic welfare of consumers in South Africa. Agreements between suppliers of property to consumers are regulated, outlawing certain unfair practices and illegal provisions and allowing the reversal of transactions under certain circumstances. The Consumer Protection Act does not apply to transactions between two contracting individuals. It only applies to suppliers whose business is the supply of properties to the public.

The land restitution process continues in South Africa. This process is to provide for restitution of land to persons or communities dispossessed of such rights after 19 June 1913 by past racially discriminatory laws or practices. The Restitution of Land Rights Act 22 of 1994 regulates the restitution of land. Subject to proposed legislation, it is possible to determine with a fair degree of accuracy whether a piece of land is subject to a claim by a community through enquiry at the local land claims office or by reviewing claims published in the Government Gazette (see Section VII.ii, *infra*). The Constitution requires that fair value be given to any property expropriated for land restitution or other purposes. Land claims have been made mostly in respect of rural property and not urban property, although certain tracts of urban property are subject to outstanding land claims. This has had an effect on investment in properties subject to land claims.

All of these pieces of legislation have affected real estate activity in South Africa to a greater or lesser degree. Under the National Credit Act, sanctions aimed at deterring reckless lending have made lenders cautious and credit no longer as freely available, so reducing the number of purchasers in the market. The Restitution of Land Rights Act has also affected activity in the relevant areas. The Consumer Protection Act requires compliance but has had little effect on real estate activity.

III FOREIGN INVESTMENT

There is no restriction on foreign investors acquiring property in South Africa.

Foreign companies wishing to acquire property in South Africa may be required to register as an external company in terms of the Companies Act 2008.

A withholding amount is payable by the purchaser of the foreign-owned immoveable property to the South African Revenue Service (SARS) pending determination of the tax liability of the non-resident seller to SARS. The current rates are 5 per cent for individuals, 7.5 per cent for companies and 10 per cent for trusts. Treaty relief may be available to taxpayers in terms of international treaties.

Before the proceeds of the sale of immoveable property in South Africa or shares in a company owning South African immoveable property may be remitted abroad by a non-resident, South African Reserve Bank approval is required, and one of the requirements for approval is that all taxes have been paid. That aside, there is generally no restriction on remitting the proceeds from the sale of a property, provided the purchase price was funded from abroad.

IV STRUCTURING THE INVESTMENT

Investors in real estate generally acquire immoveable property in South Africa using a domestic company. The company confers limited liability on the investor. Any rental income, net of expenses, derived by the company is taxed at a rate of 28 per cent. When the company disposes of the immoveable property, capital gains tax (CGT) is payable at a rate of 18.6 per cent. Should a non-resident own the shares in the domestic company and later sell the shares in the property rich company, CGT remains payable, in the form of a withholding tax, which must be paid by the purchaser to SARS on behalf of the seller. Where the seller is a natural person, CGT is payable at a rate of 5 per cent; in the case of a company it is 7.5 per cent, and in the case of a trust it is 10 per cent. The withholding tax is an advance payment of the CGT that may finally be payable by the seller. The rate of CGT applicable may be reduced by a tax treaty concluded between South Africa and the shareholder's home country.

Where the company owns commercial property and derives rental therefrom in excess of 1 million rand a year, the company must register for value added tax (VAT) and charge VAT at a rate of 14 per cent on the rentals collected by it. Any VAT paid by the company on expenses incurred by it is generally recoverable from SARS; however, where the company owns residential property and derives rental from letting such property, no VAT is chargeable and the VAT paid on expenses is not recoverable under the VAT system.

Foreign investors investing into a domestic company need to structure the investment into that company correctly so as not to fall foul of the transfer pricing and thin capitalisation rules. It is important that the company has sufficient equity and is not too highly geared, failing which the interest on the loan payable to the non-resident shareholder will not be fully deductible for tax purposes. Previously, SARS accepted a debt-to-equity ratio of 3:1, but currently loan funding must be at arm's length.

Once the domestic company has paid tax in South Africa and chooses to distribute dividends to its shareholders, a 15 per cent dividends tax is payable. This is a tax payable by the shareholder, but which is collected by the company and paid over to SARS on behalf of the shareholder. Where the dividend is paid to another South African company the dividends tax is not payable, and where the dividends are paid to a non-resident the tax is payable at a rate of 15 per cent, subject to reduction by a tax treaty concluded by South Africa with the shareholder's home country.

Currently, South Africa does not impose a withholding tax on interest paid to non-residents, but this is expected to change from 1 January 2015. It has been proposed that a 15 per cent withholding tax on interest payable to non-residents will become payable, subject to a reduction by the provisions of a tax treaty.

Alternatively, non-residents may invest in real estate in South Africa via an external company. An external company also pays tax at a rate of 28 per cent, but does not suffer the dividends tax, and no branch profits tax is payable on after-tax profits remitted to the foreign head office. The disadvantage of using an external company is that South African creditors could have recourse to foreign assets to settle claims due in South Africa. This disadvantage does not arise with a domestic company, as local creditors only have recourse against assets owned by the domestic company.

Institutions may invest in real estate investment trusts (REITs) that are publicly traded and seek investors from the general public.

V REAL ESTATE OWNERSHIP

i Planning

All land in South Africa falls under the purview of a local authority, by which planning controls are implemented. In the case of urban properties, planning control is extensive through planning ordinances, municipal by-laws and approved development frameworks of the municipalities indicating the extent to which land may be developed with support of the authorities.

Change of use of land requires planning approval, which is subject to public participation and may incur objections. Opposition to proposed changes is heard by tribunals established by the local authorities. In certain circumstances there may be appeals from those tribunals to an independent appeal body. Professional town planners practise in South Africa and are useful in assisting in proposed change of use applications.

ii Environment

South Africa has a wide range of legislation relating to the environment. These arise from Section 29 of the Constitution, which accords a fundamental right to an environment that is not detrimental to health or wellbeing. One of the principal acts is the National Environment Management Act 107 of 1998 (see Section VII.ix, *infra*), which creates a framework for integrated good environmental management for development activities.

Certain prescribed changes of use of property and activities require environmental authorisation from the relevant authority. The National Environment Management Act establishes a public participation process for the change of use of land and its environmental impact. Where approvals are granted, they are often subject to rigorous conditions and may require the implementation of environmental management plans and rehabilitation.

iii Tax

All acquisition of property in South Africa is subject to the Transfer Duty Act 40 of 1949. As a general rule transfer duty is payable; the current rate of transfer duty is based on a sliding scale for acquisition by a natural or juristic person where no transfer duty is payable for the first 600,000 rand of the purchase price (this is to assist in the purchase of lower-value properties). If the seller of the property is a registered vendor for VAT purposes, then VAT at 14 per cent is payable, and not transfer duty.

Under certain circumstances the acquisition of business premises may be subject to zero-rated VAT.

Properties that are held as private residences are subject to a primary residence rebate on capital gains tax of 2 million rand.

Capital gains tax rates are currently approximately 18.6 per cent in the case of companies and approximately 26.7 per cent in the case of trusts.

iv Finance and security

Given the accurate registration system within the various deeds registries, mortgage bonds are registered as security for landowners' obligations against the title of the property. This is the most common source of security for lenders in the property industry.

Mortgage bonds are ranked in order of preference, and a bondholder holds first preference from the proceeds of the sale of the property in the event of insolvency of the property owner. Properties may not be transferred unless the mortgage bond is cancelled. Accordingly, consent to the transfer of a property is required of the bondholder.

VI LEASES OF BUSINESS PREMISES

Leases of property in South Africa are respected and given the sanctity of contracts according to South African law. Unless such a contract is against public morals or legislative restrictions such as the Consumer Protection Act, the sanctity of those contracts will be enforced by South African courts of law.

A typical lease will include provisions relating to the contracting parties, the rental payable and the period of the lease.

Leases may be registered against the title deed of a property, and in such event offer security of tenure to a tenant under a lease, should the property be sold to a purchaser unaware of the lease. Generally, leases in excess of 10 years are registered against the title of property as leases in excess of 10 years will only be binding for a 10-year period on successors in title who were unaware of the lease.

Leases also generally include provisions relating to rent calculations in the event of turnover rental, and the payment of rates and taxes and other outgoings related to the properties by the tenant. A common occurrence is a fully maintaining lease in terms of which the tenant assumes liability for all costs arising from the property, including rates, taxes, consumables and insurance. There is no legislation protecting tenants of business premises in South Africa.

Rental increases are often linked to the consumer price index published by the government. Arbitration clauses are common in extensive leases.

Leases of business premises still to be constructed often include the construction obligations relating thereto insofar as they are relevant to the tenant.

Generally, the landlord will insure the premises, as it has an insurable interest in the building. Clauses relating to damage and destruction of the premises often require considerable negotiation as the needs of the tenant may differ from the needs of the landlord, particularly if the lease is security for the financing of the building.

VII DEVELOPMENTS IN PRACTICE

i Land Claims Commission

While the South African system of registration of title in land is based on old and well-tried legislation, since free elections in 1994 and the implementation of the new Constitution in the country, a number of laws that directly affect real estate have been passed, many of which are required in terms of the Constitution; many of these protect previously disadvantaged communities. One of the main cornerstones of land reform is the Restitution of Land Rights Act No. 22 of 1994. The legislation established a Commission on Restitution of Land Rights, now known as the Land Claims Commission, and a Land Claims Court. In terms thereof, persons are entitled to lodge a claim for restitution of land with the Land Claims Commission. The Commission is then required to investigate the claim and, if the claim has merit, to publish the claim in the Government Gazette. Thereafter, the claim may be resolved in a number of ways. The state must settle the claim and compensate the owners of land, should the land be found to have been expropriated by the government, for restitution purposes; fair value is required to be paid by the government. Where matters cannot be resolved, the Land Claims Court may hear the matter and make rulings. All land claims had to be filed with the Land Claims Commission by December 1998, and as the law presently stands, no new claims may be entertained. Whether land has been claimed can be checked. The government has indicated through proposed legislation that it will again open the period to lodge land claims until 2018. This legislation has not yet been passed into law. If it is, it will again bring about uncertainty in the market, as the ability to check whether land has been claimed will be postponed until the 2018 cut-off date. The Land Claims Commission continues to settle land claims by agreement with land owners.

ii Fast-track developments

In an effort to fast-track housing developments, the Development Facilitation Act No. 67 of 1985 was put in place. This enabled tribunals to make rulings, fast-track land developments, and override planning procedures and other laws; however, the Constitutional Court has since found this Act to be unconstitutional, and has ruled that the government should revisit the procedure and this legislation. No such replacement legislation has been promulgated, although the provinces are all to have new provincial ordinances for planning purposes. Kwa-Zulu Natal is one such province that has its own ordinance. Others are still in bill form.

iii Protection of tenants

The Land Reform (Labour Tenants) Act No. 3 of 1996, the Interim Protection of Informal Land Rights Act No. 31 of 1996, and the Prevention of Illegal Eviction from and Unlawful Occupation of Land Act 19 of 1998 all provide security of tenure to particular classes of tenants. The legislation, while giving protection to tenants, does not restrict landowners from approaching a court of law for the eviction of those tenants. The principles of justice and fairness must, however, be implemented by the court, and justice and equity must prevail.

iv Communal property associations

The Communal Property Associations Act No. 28 of 1996 enables communities to form juristic persons known as communal property associations to acquire, hold and manage property on a basis agreed by members of a community in terms of a written constitution. This is, in essence, to allow restitution of land to communities and to create legal entities to hold land for the benefit of communities. The associations are registered at a central registry, and upon registration assume legal identity.

v Sustainable housing

The Housing Act No. 107 of 1997 was promulgated to provide for the facilitation of a sustainable housing development process, and in so doing to define the functions of national, provincial and local governments in respect of housing developments. A South African Housing Development Board is established under this legislation, which is to give priority to the needs of the poor in respect of housing development.

vi Water

In keeping with the new legislation relating to water, the Water Services Act No. 108 of 1997 was promulgated to provide for the setting of national standards and of norms and standards for tariffs, and to provide for water services development plans and a regulatory framework for the institution of water services. This is in keeping with, and gives effect to, the constitutional right of access to basic water supply and basic sanitation.

vii Roads

The South African National Roads Agency Limited and National Roads Act No. 7 of 1998 makes provision for a National Roads Agency for the republic, to manage and control the national road systems and to take charge, *inter alia*, of the development, maintenance and rehabilitation of national roads within the framework of government policy. A National Roads Agency is established under that legislation, which is a public company wholly-owned by the state. That entity is governed and managed by a board of directors and they are required to implement government policy relating to national roads.

viii Rental accommodation

The Rental Housing Act No. 50 of 1999 defines the responsibility of the government in respect of rental housing property and creates mechanisms to promote the provision of rental housing.

ix Environmental issues

The National Environmental Management Act No. 107 of 1998 is one of the many pieces of legislation to provide for the constitutional requirement of the state's responsibility to respect, protect, promote and fulfil the social and economic rights, and to set out a general framework within which environmental management and implementation plans must be formulated. In addition, the National Environmental Management: Protected Areas Act No. 57 of 2003 provides for the protection and conservation of ecologically viable areas and the natural landscapes and seascapes. In essence, the Act provides for the declaration and management of protected areas such as special nature reserves, national parks, nature reserves and other protected areas. It also protects world heritage sites, marine-protected areas, special forests and forest reserves, and mountain catchment areas.

x Property rates

The Local Government: Municipal Property Rates Act No. 6 of 2004 (the Rates Act) regulates the power of a municipality to impose rates on property, and makes provision for municipalities to implement a transparent and fair system of rating, exemptions, reductions and rebates through rating policies. The valuation methods of properties must be fair and equitable, and permit objections and appeal processes to be implemented. Municipalities must adopt rates policies in terms of this Act. A Bill was published in 2013 for comment that will clarify a number of issues arising from the Rates Act. All municipalities are required to have policies for the rating of properties in keeping with the Rates Act.

xi Mineral and petroleum resources

The Mineral and Petroleum Resources Development Act No. 28 of 2002 makes provision for equitable access to and sustainable development of the nation's mineral and petroleum resources. In terms of the Act, mineral and petroleum resources are the common heritage of all the people of South Africa and the state is the custodian thereof for their benefit. The state grants and administers all prospecting and mining rights in the country. The Act sets out the parameters within which the holders of rights may operate and procure and renew those rights. Application for mining rights must be made to the relevant minister in terms of the legislation.

VIII OUTLOOK AND CONCLUSIONS

The land reform programme continues in South Africa, but this largely relates to rural and agricultural properties. This has had an effect on investment in properties subject to land claim, even though in the case of an expropriation of land, fair value for the land must be paid to the expropriated owner. The proposed extension of the time frame for lodging land claims to 2018 will cause much uncertainty and may affect the property market.

A Green Paper on land reform has been published by the government to elicit comment and debate on the land and tenure system in South Africa; it sets out a number of ideological statements and indicates that there should be further debate about land reform and rural development. This Paper also provides for the establishment of a Land Management Commission, which will be an entity established by government to control and regulate land issues in South Africa.

The Green Paper clearly recognises that land reform should continue and that the current land reform and restitution programme has not succeeded; however, it does recognise the concept of privately owned freehold land as well as communal land. There is an indication that land owned by foreigners should be restricted, and in certain cases subject to conditions that require compliance. The government published the Green Paper to address land issues in South Africa and to generate debate, and it should be seen in that light. There has been no progression from the Green Paper towards legislation.

There appears to be recovery from the global economic downturn, but the restrictions on lending resulting from the National Credit Act will continue to have an effect on the real estate market, and the boom or bust cycles should not be as marked in the future. That said, South Africa does have a first-class definite registration system and property rights are protected by the Constitution, and these ensure that property investment in South Africa remains a sound proposition.

Chapter 33

SPAIN

Diego Armero and Rodrigo Peruyero[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

The most common type of ownership in Spain is absolute property. It is similar to the common law concept of freehold and grants the title holder absolute rights to transfer, use and encumber real estate.

Spanish law also recognises other types of ownership or real estate rights that can be used or considered when exploring investments in commercial real estate. These are as follows:

a Surface rights: these types of rights are similar to common law ground leases and temporally separate land ownership from that of the construction to be built over it. It grants the tenant the right to build and own a construction over third-party land in exchange for consideration and for a limited period (up to a maximum of 99 years), after which ownership of the construction reverts back to the landowner. Surface rights are sometimes used by renewable energy companies setting up solar and wind farms as it allows the beneficiary of the surface right to reduce the project cost (for not having to purchase the land) and to mortgage the construction over the land.

b Administrative concessions: these rights are usually granted over public land that cannot be owned by individuals or companies (i.e., sea and riverside areas, harbours, docks and green areas). The public administration owning the land grants the right to use, develop and operate the public land to a third party in exchange for consideration and for a limited period. Even though it will not acquire ownership over the land, the third party will also benefit from other rights typically vested in freehold owners, such as the right to transfer or encumber the

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administrative concession. Such rights, however, are subject to certain limitations (usually requiring the prior authorisation of the public administration owning the land and an obligation by the new holder to continue honouring the terms and conditions of the concession).

Spanish law recognises other types of rights over real estate, such as usufruct, which provides the legal right to use and obtain benefit from property owned by a third party in exchange for consideration and for a limited period, but these other rights are very rarely used in commercial transactions.

ii System of registration

Freedom of form applies to real estate transfers, requiring only a valid written contract and the delivery of possession of the property. In practice, however, transfer of real estate is always carried out by transfer deed because it is a requirement for entry in the Land Registry. Although registering with the Land Registry is not compulsory (except for mortgages and surface rights, where registration is a requirement), it is advisable, as registration grants protection to good-faith third-party purchasers who acquire title from a registered owner in exchange for consideration. Ownership cannot be successfully challenged by a third party holding a right that was not recorded at the Land Registry, even if title of the registered transferor is later deemed void on grounds that are not recorded at the Land Registry.

Since transfer of ownership is usually effected by notarial deed and its subsequent registration with the Land Registry, notary and registry fees must be paid. Notary fees are calculated on the basis of the value of the recorded transaction; for transactions in excess of €6 million, however, notarial fees can be freely negotiated and agreed beforehand.

Registry fees, although calculated on the basis of the transaction, are capped at €2,200 per registered plot and are not negotiable. Other than taxes (see Section VI.iv, *infra*), there are no significant costs.

Transactions with no actual transfer of ownership (i.e., conditional sales subject to conditions precedent) are formalised in a private contract rather than a transfer deed, avoiding notary and registry fees. The notarial deed will be formalised on completion, following fulfilment of the relevant conditions precedent.

iii Choice of law

In commercial real estate transactions, the acquisition of assets is typically structured through a Spanish special purpose vehicle (SPV) (see Section IV.i, *infra*). Since the seller will most likely be a Spanish company, it is commercial practice to choose Spanish law as permitted by the principle of freedom of choice established in Regulation (EC) No. 593/2008 on the law applicable to contractual obligations (Rome I).

II OVERVIEW OF REAL ESTATE ACTIVITY

The need for cash and a steep fall in valuations are shaking the market. SAREB (the Spanish bad bank), financial institutions, government bodies and distressed real estate companies have been the main sources of real estate opportunities.

i SAREB

Bailed out banks have transferred to SAREB assets worth €65 billion (including land, mortgage loans and properties that are either finished or under development) with a discount of approximately 63 per cent over the book value. Assets have been organised into portfolios and are being sold to institutional investors through bidding processes that have attracted the interest of international institutional investors. Since the creation of SAREB last year, it has sold assets worth €2 billion. A large number of transactions are being organised thorough banking asset funds, a particular investment vehicle specially designed to acquire assets contributed to SAREB. See section VII, *infra* for further details.

ii Financial institutions

As part of their general recapitalisation process, banks are seeking fresh cash through sale and leaseback deals and the sale of portfolios of mortgage loans and repossessed assets. Most of them have also sold the asset management platforms that they put in place to manage their large portfolios of real estate assets in 2013.

iii Government bodies

Regional and local bodies are also very active, and auctions for the sale of all types of real estate assets are being organised. Institutional investors have purchased portfolios of public housing apartments, office buildings and plots of land for further development.

III FOREIGN INVESTMENT

The acquisition of commercial real estate in Spain by foreign institutional investors or funds is typically structured through a Spanish SPV owned by a foreign company (see Section IV.i, *infra*). The acquisition of the SPV by the foreign company does not require prior authorisation but must be reported to the Ministry of Economy and Finance by filing form D-1A within 30 days of the date the shares are acquired. This records for statistical purposes corporate information on the foreign company (corporate name, registered address, nationality), the Spanish SPV (corporate name, registered address, share capital and reserves, whether the foreign shareholder has the ability to appoint its directors) and the value of the transaction. If the foreign company is a tax-haven resident, form DP-1 must be filed prior to the acquisition of the Spanish SPV (again, for statistical purposes rather than authorisation) followed by form D-1A on completion the purchase of the shares.

The very few exceptions requiring prior clearance for the acquisition of real estate concern investments in state defence-related properties (or properties located near defence sites), or investments from tax havens or by foreign sovereign bodies.

IV STRUCTURING THE INVESTMENT

Each investor is different and has its own goals, targets and demands when considering real estate investments.

Real estate investments can be made by acquiring the property directly (asset deal) or indirectly by purchasing the share capital of the legal entity owning the real estate (share deal). The decision between direct or indirect investment is usually tax-driven.

i Asset deals

Real estate investments are normally structured as an asset deal in which a Spanish SPV owned by a foreign company (typically, a company incorporated in the Netherlands) purchases the asset.

On the Spanish tax side, the acquisition of a property by the Spanish SPV will be subject to VAT if certain requirements are met (see Section VI.iv, *infra*) and not to non-recoverable transfer tax, and it will be subject to Spanish corporate income tax, generally at a rate of 30 per cent, on its net income (and capital gains). Interest, amortisation and expenses are generally deductible if they are linked to the company's business activities and transfer pricing rules are complied with.

The use of Spanish SPVs by Dutch companies is very common in real estate transactions for the following reasons:

a capital gains realised upon divestment will not be taxed in Spain when made through the sale of the stake of a Spanish SPV if the shareholder is entitled to the benefits of the Spain–Netherlands double taxation treaty (which is generally the case); and

b profits distributed by a Spanish SPV to a Dutch company will be exempt from withholding tax in Spain if certain Spanish tax law requirements are met (mainly the Parent-Subsidiary Directive requirements).

Other EU jurisdictions, such as Ireland or Luxembourg, can also be taken into consideration (although capital gains of an Irish or Luxembourg company derived from the alienation of shares in a Spanish real estate company are taxed in Spain).

ii Share deals

Share deals were generally disregarded, because the acquisition of more than 50 per cent of the shares of a company with more than 50 per cent of assets as real estate is subject to non-recoverable transfer tax (payable by the purchaser) at a rate of between 2.5 per cent and 11 per cent over the market value of the property (depending on the region in which the real estate is located). However, the new drafting of Article 108 of Law 24/1988 of 28 July on the securities market (the SML), introduced by Law 7/2012 of 29 October, only excludes from the general indirect tax exemption applicable to the transfer of shares those that are intended to avoid the payment of taxes applicable on the transfer of real estate.

According to the new drafting, the SML assumes (unless there is evidence to the contrary) that indirect taxes applicable to the transfer of real estate assets would not be triggered in the following cases:

a When, as a consequence of a secondary market transfer of shares in a company, the assets of which mainly comprise real estate located in Spain and which is not used in a business activity (a real estate company), or in a company that has a stake in a real estate company; the acquirer gains control (or if it already had control, it increases its stake) in the relevant real estate company.

b When there is a transfer of shares that had been previously received in exchange for the contribution of real estate and that occurred less than three years before, provided that the relevant real estate is not used in a business activity.

Other noteworthy features of the amended version of Article 108 include the following:

a taxation on the acquisition of shares in the primary market is excluded; and

b if the transfer of shares is subject to tax, this will be subject to VAT or to transfer tax, depending on the tax applicable to the direct transfer of the real estate assets owned by the company whose shares are being transferred.

iii Sale of the property

Profits from real estate investments are subject to general direct taxation rules. Capital gains from the transfer of property will be determined based on the difference between the transfer price and the net book value of the property. Spanish corporate tax law allows a reduction of the effective tax rate from 30 per cent to 18 per cent in the event of reinvestment under certain conditions.

V REAL ESTATE OWNERSHIP

i Planning

The autonomous regions have exclusive competence on planning (except for some very basic aspects in the hands of the central state). Spain has 19 different jurisdictions and, as a consequence of their differing needs, geography and economic development, some regions have a more liberal approach than others.

While regulatory power lies with the regions, its implementation is handed over to the municipalities (although the most important matters are subject to control by the regions). This requires the cooperation of a number of administrations and other parties, including local authorities (who ultimately decide if and under what conditions land can be developed), regional authorities (who play a supervisory role) and, to a lesser extent, the state authorities (who legislate and supervise matters such as main roads, harbours, coastal areas, aviation liens and airports). Because of the different authorities and pieces of legislation involved, planning matters in Spain are complex (particularly the purchase of land for subsequent development) and should be carefully addressed with a planning expert.

ii Licences

Although requirements vary across municipalities, usually the licences and permits required for the construction and operation of buildings are as follows:

a a works and activity licence, which must be obtained prior to starting construction works;

b a first occupancy licence, which verifies that the construction complies with the terms authorised by the works licences; and

c operating licences, which will verify that the use carried out in the building complies with the relevant zoning regulations as well as health and safety and environmental matters.

Other permits and licences may be required by the regional governments depending on the activity to be carried out. For instance, some regions require a commercial licence for an operator to open a large retail scheme (i.e., those exceeding a minimum sales surface area foreseen in the relevant legislation) or a tourism authorisation in the case of hotels.

iii Environment

For a piece of land to be declared polluted, the contamination detected must exceed the parameters set out by Royal Decree 9/2005; these parameters have been determined with regard to the land use (industrial, residential, etc.). The competent authority to declare soil polluted is the environmental department of the regional government where the site is located.

Whenever a piece of land is formally declared polluted, the polluter will be ordered to carry out the cleaning and remedial activities required for the decontamination of the site; if several polluters are involved, they will be jointly and severally liable. As a general rule, in the absence of the polluter, the obligation to carry out cleaning and remedial activities falls on the owner and thereafter on the possessor of the site.

Finally, the owner of a site where an activity potentially polluting of the soil (listed in Annex I to Royal Decree 9/2005) has been carried out must declare such circumstance in the public deed of transfer; this must be registered with the Land Registry. This information will only be removed from the Land Registry on completion of the remedial activities and subsequent validation of the decontamination works by the regional government.

iv Tax

VAT and transfer tax

As a general rule, the first transfer of properties by sellers in the course of a business activity is subject to VAT at a rate of 21 per cent; for dwellings, however, the rate is 10 per cent. In all other cases, transfers are subject to transfer tax at a rate between 2.5 per cent and 11 per cent of the purchase price (depending on the autonomous region where the property is located).

Second and subsequent transfers of built properties made in the course of a business activity are, however, technically subject to but exempt from VAT, and thus subject to transfer tax; the exemption can be waived by the parties when the seller and the buyer are VAT registered and the purchaser is entitled to a 100 per cent VAT credit allowance. If the exemption is waived, VAT (not transfer tax) will be levied on the transfer.

Meeting the requirements to waive the VAT exemption is relevant, since input VAT incurred upon the acquisition of real estate is, generally, fully deductible. This is not the case with transfer tax, which is a final cost for the acquirer. Therefore, where conditions are met, the VAT exemption is waived to avoid paying transfer tax (a sunk cost).

If VAT is waived, the reverse charge mechanism would apply, and the acquirer of property would be considered to be the VAT taxpayer having the obligations to waive the corresponding VAT exemption, to charge itself the VAT derived from the acquisition and to directly declare the VAT arising from the acquisition of the property (thus generally resulting in a neutral scenario, as output and input VAT will be compensated in the VAT return).

Stamp duty

Stamp duty is levied upon the notarial deed if the transfer is subject to and not exempt from VAT, in which case stamp duty will be levied at a rate of between 0.25 per cent and 2 per cent, depending on the autonomous region in which the real estate is located; or if the transfer is subject to but exempt from VAT and the exemption is waived, in which case stamp duty is levied at a rate between 0.25 and 2.5 per cent, depending on the autonomous region in which the real estate is located.

Stamp duty is paid by the acquirer. Stamp duty is paid on many other occasions, including the creation of mortgages and certain other charges in the Land Registry, at a rate of 0.25 per cent to 2 per cent.

Real estate tax (RET)

RET is a municipal tax levied annually on owners of Spanish real estate and *in rem* rights. This tax is based on the cadastral value of the real estate evaluated pursuant to the regulations of the cadastre. Owners of real estate must pay RET to the local authority where the real estate is located on an annual basis. RET will only be due if the cadastral value of the real estate is assessed and formally notified to the taxpayers.

Under the Spanish Local Taxes Law, the tax base is the cadastral value, which is an objectively determined value assigned to each property based on the data and information existing in the cadastre. The cadastral value is updated every 10 years and adjusted to the current market value.

The RET rate for urban real estate depends on the relevant municipality regulations and ranges between 0.4 per cent and 1.1 per cent.

v Finance and security

Spanish law sets forth a wide range of security packages similar to those used in other jurisdictions (e.g., mortgages, pledges of the bank accounts held by the borrower to administer the income generated by the property, pledge of receivables held or to be held by the borrower, such as the lease rent, insurance compensations and VAT refund rights, and pledges over the borrower's shares).

Mortgages are the preferred and most commonly used security interest. Mortgages are security interests, enforceable with regard to third parties, which enjoy significant privileges and can be granted over any type of real estate. The mortgagee may enforce the collateral to the exclusion of most other creditors following relatively simple and expeditious foreclosure proceedings. A mortgage can secure all kinds of payment obligations, including, in particular, principal, interest, default interest and fees in respect of loans and credit facilities. In the case of insolvency of the borrower, the lender is not able to foreclose on the mortgage until one year after the date the insolvency was declared or the date a composition agreement with the creditors was approved.

To be valid and enforceable, a mortgage must be formalised in a notarial public deed and recorded with the relevant Land Registry. This triggers the obligation to pay notarial and registry fees, as well as the obligation to pay stamp duty at a rate of 0.25 per cent to 2 per cent of the maximum amount secured by the mortgage (typically 130 per cent to 140 per cent of the loan principal).

VI LEASES OF BUSINESS PREMISES

Freedom of contract governs lease agreements for business premises, except regarding lease bonds (the tenant must provide a bond equal to two months' rent) and court jurisdiction (claims must be filed before the first-instance court within the city where the property is located unless the parties have agreed to submit claims to arbitration), which cannot be waived or agreed upon differently by the parties. Any matter not contemplated by the parties in the lease agreement is governed by the provisions of the Spanish Lease Act and the Spanish Civil Code.

i Initial lease term

The lease term can be freely agreed by the parties, and the average term depends on the type of property being leased. For instance, lease agreements in a shopping centre or retail park would usually be agreed for a five-year term (subject to renewals), while a lease of a single tenant office building would be agreed for a longer term (10 to 15 years) and even above 15 years in sale and leaseback transactions.

ii Renewals

There is no statutory right of renewal, and the parties may either expressly exclude or include the possibility of renewal in the lease agreement. It is market practice to include a term providing that any lease renewals be subject to a market rent review. If there is no express provision and the tenant continues to lease the premises with the landlord's consent for 15 days after the lease has expired, the Civil Code allows the tenant to renew the lease for a term equal to the periodicity of the rent payment (e.g., a month if the rent were paid monthly).

iii Rent review

The Spanish Lease Act does not regulate rent reviews, and parties generally agree annual reviews according to the Spanish consumer price index, published monthly by the National Statistics Institute. Market rent reviews are usually agreed as a condition of renewal and are even found in long-term leases (e.g., a 15-year lease will have a market rent review in year seven).

iv Service charges

There are no legal restrictions on the landlord's ability to recover service charges from tenants, and the amount to be recovered very much depends on the tenant's bargaining power. The tenant's contribution to service charges is usually calculated on the surface area occupied by the tenant's premises. Anchor tenants may benefit from caps to service charge contributions or even be able to agree a fixed monthly contribution. Triple-net leases are not uncommon in Spanish commercial lease practice and are usually required by investors' sale and leaseback transactions. Recoverability of RET is usually an important issue when negotiating leases, as it represents a big cost for the owner.

v Lease bond

Upon execution of the lease agreement, the tenant has to provide a bond equal to two months' rent. The lease bond cannot be reviewed (upwards or downwards) during the first five years. From the sixth year onwards, the lease bond will be reviewed in accordance with the terms of the lease contract. Failing that, it will be reviewed, following the rent-review provisions in the contract, so that the lease bond is always equal to two months' rent.

vi Assignment and subletting

Unless otherwise agreed by the parties, tenants may sublet or assign the premises to any third party without the landlord's consent. Unless otherwise agreed by the parties, the landlord may increase the rent by 10 per cent for partial sublets, and 20 per cent for total sublets or assignments.

vii Maintenance and repair

Even though the Spanish law on urban leases contains provisions on maintenance and repair duties, it is commercial practice to replace these (on the freedom-of-contract principle) with more landlord-friendly provisions. Typically, the parties agree that the tenant must repair any damage to the premises and perform any actions necessary to keep the premises in a good state of maintenance and repair, and that the landlord carry out any such works affecting the structure and façade of the premises. The tenant is not entitled to carry out repairs that may affect the structure of the premises without the landlord's written consent.

viii Insolvency

The Spanish Insolvency Act provides for the continuation of the lease agreement in the event of the tenant's insolvency, as it expressly states that the declaration of insolvency does not affect any existing agreement that provides for reciprocal obligations that both parties have yet to perform.

Any outstanding payment obligations under the lease agreement will be payable to the landlord directly against the insolvency estate, as these credits will not be subject to the moratorium or reduction rules laid down in the insolvency proceedings. An insolvent tenant may reinstate the lease agreement and stop eviction proceedings by the landlord before the declaration of insolvency at any time before the eviction takes place by paying all amounts due, including the landlord's court costs up to such time. This right to reinstate the lease is allowed only once.

ix Tax

Spanish real estate leasing activity of business premises is subject to and not exempt from Spanish VAT. The applicable rate for the leasing of Spanish business premises is 21 per cent.

VII DEVELOPMENTS IN PRACTICE

i Acquisition of assets from SAREB – banking asset funds

As previously mentioned, the creation of SAREB has boosted the Spanish real estate market. Despite being commonly known as the bad bank, SAREB does not have a banking licence and does not give any vendor financing. It merely manages the assets contributed to it with the purpose of selling them within a maximum 15-year term, at the end of which term it will be liquidated.

Investors are acquiring real estate assets from SAREB directly through straightforward asset deals or indirectly thorough the creation of banking asset funds (BAFs). The main characteristics are as follows:

a BAFs have a hybrid nature, and are somewhere between securitisation funds and collective investment funds. They have been designed as a mechanism that SAREB may use to isolate assets on a case-by-case basis (i.e., according to the type of asset or credit standing) to achieve off-balance sheet treatment. Investors may actually request that SAREB create a BAF with a portfolio of assets of their choice. Investors would then hold the securities issued by such BAF and would be entitled to the proceeds of the underlying portfolio transferred to the BAF.

b No minimum number of investors is required; therefore, it is possible that a single investor can request SAREB to create a BAF and be the single holder of the securities.

c Securities issued by BAFs will be subject to the relevant Spanish Stock Market regulations, may be admitted to trading and may only be offered to and subscribed by professional investors.

d SAREB will not be allowed to guarantee the performance of the loans and the credit receivables or, in general terms, the value or quality of the transferred assets. Transfers must be final and unconditional, they will not be subject to claw backs under the Spanish Insolvency Law, and the transferred assets will not qualify as an ongoing concern or trigger an extension of liability for tax or social security obligations.

e The tax benefits granted to BAFs have incentivised the use of these particular vehicles. As shown in the following table, from a tax perspective, using a BAF to invest in real estate contributed to SAREB shows real advantages over using a normal SPV:

Type of tax	*BAF*	*SPV*
Corporate income tax	1%	30%
Taxes on real estate or mortgage loans acquired from SAREB	Transfer tax: exempted Stamp duty: exempted	Transfer tax (3% to 11%) Stamp duty (0.5% to 2%)
Local transfer tax	Yes (unless the acquirer is a BAF) Holding period computed since original acquisition by SAREB	Yes
RET	Yes	Yes
Dividends (non-residents)	No (while the Fund for the Spanish Bank Restructuring (FROB) holds a 5% stake in SAREB)	Yes (unless domestic legislation or a tax treaty establishes an exemption or a reduced tax rate)
Capital gains (non-residents)	No (while FROB holds a 5% stake in SAREB)	Yes (unless domestic legislation or a tax treaty establishes an exemption or a reduced tax rate)

ii Greater flexibility and better taxation for Spanish REITs (SOCIMIs)

The government has decided to revamp the legal regime applicable to SOCIMIs to make them more appealing. The main changes that have been introduced are as follows:

a SOCIMIs will be taxed at a zero per cent rate for corporate income tax provided that the shareholders owning at least 5 per cent of the SOCIMI are taxed on the dividends they receive at a minimum 10 per cent tax rate.

b Income obtained by Spanish tax residents holding shares of a SOCIMI (i.e., dividends or capital gains) will be subject to personal income tax applicable to savings income, which currently ranges from 21 per cent to 27 per cent, and not to personal rental income tax, which can be as high as 51 per cent.

c Income obtained by non-resident investors will be subject to withholding tax rates established in the relevant tax treaties on dividends or gains they obtain from their participation in the SOCIMI.

d The minimum lease period applicable to assets owned by SOCIMIs has been reduced from seven to three years.

e The minimum share capital has been reduced from €15 million to €5 million.

f The 70 per cent limit of external financing has been derogated and is no longer applicable.

g Shares of SOCIMIs can be traded not only in regulated markets but also in multilateral trading systems, and not only in Member States of the EU or of the European Economic Space but also in any other country to the extent that they have actual exchange of tax information arrangements with Spain.

iii Residence permits in consideration for acquisition of real estate

The government has finally passed a law that contemplates the granting of residence permits to foreigners who buy properties whose net value (not counting mortgage financing) is at least €500,000.

VIII OUTLOOK AND CONCLUSIONS

The establishment of SAREB, signs of an economic recovery and the increased confidence in the Spanish financial sector (as shown by the acquisition of banks and significant stakes in financial institutions by international institutional investors) have triggered a sharp rise in real estate deals.

During 2013, investment funds have purchased real estate assets worth more than €3 billion and non-performing loans for an aggregate face value of €6 billion, while foreigners have purchased 17.2 per cent of the properties sold in Spain (up 25 per cent from last year). Spain ranks now third among the most attractive real estate markets in Europe after the UK and Germany, and it seems that the upward trend will continue in 2014.

Chapter 34

SWEDEN

Patrick Forslund and Niclas Winnberg[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

Even though there are a number of special laws and regulations relevant to real estate law such as the Planning and Building Act and the Cadastral Act, most aspects of Swedish law relating to real estate are governed by the Swedish Land Code and the Swedish Environmental Code.

i Ownership of real estate

All land in Sweden is divided into property units that are registered in the Land Register. Real estate ownership is always connected to a property unit and the most common types of holding of real estate under Swedish law are absolute ownership and leasehold.

An owner of real property has the right to occupy, use and dispose of land and associated buildings that are located on the real property and owned by the real property owner.

A leasehold is a right to use the real estate for a certain purpose in exchange for payment of a leasehold fee. A leasehold agreement must be in writing, and can only be terminated by the real estate owner on the expiry of certain periods and only if the real estate is to be used for a different purpose from the existing use. The notice of termination must be served at least two years before the expiry date unless a longer notice period has been agreed between the parties. In practice, the term of the leasehold is regarded as unlimited, as the leaseholder is unable to terminate the leasehold agreement and the landowner cannot, as a general rule, terminate the leasehold agreement without compensating the leaseholder for the market value of buildings and other constructions on the property. The holder of the leasehold may freely transfer or pledge the leasehold. A leasehold can only be granted by the state, municipalities and, in some cases, by

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foundations on land owned by such entities. Both holdership of a leasehold and absolute ownership of land must be registered in the Land Register.

ii System of registration

Ownership of land and leaseholds must be registered in the Land Register, which includes information regarding ownership, mortgages, leasehold and easement agreements, and is kept by the National Land Survey Authority. When real estate or a leasehold is transferred, an application for registration must be sent to the National Land Survey Authority within three months of the date of completion of the transfer. If the application is not submitted on time, the National Land Survey Authority may issue an order along with a fine.

iii Choice of law

In Sweden, real estate transactions are, unless otherwise agreed, governed by the Land Code in the case of a direct transfer of real estate (or leasehold) and the Sale of Goods Act in the case of a transfer of companies holding real estate. Most transactions of a more substantial size are made using terms excluding the application of the provisions of the Land Code and the Sale of Goods Act.

II OVERVIEW OF REAL ESTATE ACTIVITY

Compared with many other economies, yields have remained at relatively low levels on the Swedish real estate market since the credit crunch in 2008.

The dominance of Swedish investors, primarily institutions and financially strong private real estate companies with good credit access, has continued during 2013, and by the end of Q3 2013 the international share of investments was less than 12 per cent.[2] Residential properties have attracted a lot of interest from investors, with a market share of nearly 40 per cent reported in early September 2013.[3] Furthermore, there is increased activity in higher yield segments.

At the time of writing, the total volume of real estate transactions with a transaction value exceeding 100 million kronor has been estimated to be 91 billion kronor,[4] which is lower than the figure for 2012 (107 billion kronor). The major difference in activity between 2012 and 2013 is that a number of very large transactions were made during the last quarter of 2012.

In 2013, the willingness of banks to finance real estate transactions is reported to have increased, but this has not yet had any significant effects on the volumes of real estate transactions. With an increasing number of reports of recovery in the Swedish economy and reported increased interest in segments with higher yields than primary locations, hopes for increased activity on the real estate transactions market during 2014 are high.

2 DTZ Investment Market Update Sweden Q3 2013.

3 Newsec Property Outlook Autumn 2013.

4 Newsec.

III FOREIGN INVESTMENT

Swedish law does not impose any restrictions on foreign investment in Swedish real estate except in relation to agricultural and forestry estates, where general restrictions apply. Despite this, most foreign investors in Swedish real estate make their investments through limited liability companies (see Section IV, *infra*).

Compared with those in many other countries, the Swedish real estate market is still regarded as a relatively safe place to make investments because the economy is performing relatively well. Another benefit of the Swedish market is that it has a transparent system, both from a legal and a commercial point of view, with easy access to reliable information. The costs for making investments in Sweden are also relatively low.

IV STRUCTURING THE INVESTMENT

Real estate transactions in Sweden are usually carried out as share transactions. This is mainly because a corporate seller is able to realise a tax-exempt capital gain on the sale of shares, whereas a gain on a direct sale of real estate is subject to corporate tax. As from 1 January 2013, the corporate tax rate is 22 per cent. In addition, in contrast to a direct sale of real estate, there is no stamp duty on a share transaction, which is its main advantage.

The main disadvantage for an investor in a share transaction is that the basis for depreciation of the real property may be low when the property is held by a company, and particularly when the property has been held for a long time. In a direct sale, the basis for depreciation for the investor would be the fair market value of the property. Land may not be depreciated.

An investor is thus often faced with purchasing shares in a limited liability company holding real estate. Swedish holding companies to invest in a company holding the real estate (the property company) are popular investment structures. The main advantages of the holding company structure are the ability to deduct interest on debt from the acquisition of the property company and the fact that any gain on the subsequent sale of the shares in the property company is generally tax-exempt under the participation-exemption regime.

Interest on investment in a property company is generally deductible for the holding company, subject to arm's-length terms; there are no thin capitalisation rules in Sweden. Interest paid to resident or non-resident lenders is not subject to withholding tax, except for interest paid to resident private individuals. From 1 January 2013, restrictions apply for interest deductions on interest paid to affiliated parties in low-tax jurisdictions (see Section VIII.v, *infra*).

The holding company and the property company may use the Swedish tax rules on tax consolidation to offset profits and losses, which in Sweden is effected through group contributions. The company paying the contribution is allowed a tax deduction on its tax return and the company receiving the contribution reports the amount received on its tax return as taxable income. Losses of the holding company due to interest expenses may thus offset profits in the property company by way of group contributions. The main requirement for group contributions is a holding of more than 90 per cent of the shares in the subsidiary for the entire financial year.

A subsequent sale of the shares in the property company would generally benefit from the Swedish tax rules on participation exemption. A capital gain on a sale of shares held as a financial fixed asset is generally tax-exempt under these rules. A capital loss is not deductible. There is no minimum holding or holding period required for the tax exemption for shares in a privately held company.

Dividends paid by the property company would generally be tax-exempt to the holding company, and dividends paid by the holding company would generally be tax-exempt to a resident corporate shareholder or a resident institutional investor. Dividends paid by the holding company would not be subject to Swedish withholding tax if paid to a corporate shareholder resident within the EEA. The withholding tax exemption generally also applies to corporate shareholders resident in jurisdictions with a tax treaty with Sweden. A gain on the sale of the shares in the property company can thus be distributed in many cases to a resident corporate shareholder as a tax-exempt dividend and without Swedish withholding tax to a non-resident corporate shareholder.

The holding company structure may also be used for a direct investment in real estate in which both the holding company and the property company are established by the investor and the property company makes the investment. The main advantages for the investor are that the investment is made at fair market value, which would be the basis for tax depreciations, and the possibility of a tax-exempt capital gain on a future sale of the property company. A disadvantage for the investor, however, is the stamp duty payable on the investment in this situation.

V REAL ESTATE OWNERSHIP

i Planning

A new Planning and Building Act was implemented on 2 May 2011 (see Section VII, *infra*), which replaced its largely similar predecessor of the same name. This Act is the principal regulation concerning zoning, planning and use of land in Sweden, and includes provisions relating to the planning of land and water areas as well as the construction of buildings. According to the Act, the municipality is responsible for planning the use of land and water areas by way of comprehensive plans covering the entire municipality, and detailed development plans regulating in more detail the use of certain land for specific purposes, suitability for building and how the building environment should be formed.

Most construction works require a building permit, which is issued by the municipality upon application. One material concept introduced by the new Planning and Building Act is that the granting of a building permit is in principle a prohibition on using the property and the relevant part of the property in question until the municipality has issued a decision in the form of a final document stating that the constructions have been completed in accordance with the building permit and that the premises may be used. This regulation is expected to create difficulties in cases where the municipal decision is delayed beyond the date on which the tenant wishes to take possession of its new premises.

ii Environment

Under Swedish law, an operator causing contamination is primarily responsible for remedial actions; however, if no operator is able to conduct or pay for remedial action, a purchaser of real property may become liable for the contamination provided that it knew or should have known about the contamination at the time of the acquisition of the property. Such liability, however, only applies to real property acquisitions made after 31 December 1998. Regardless of the property owner's liability regarding remediation, an owner may be liable for the part of the costs of the remediation carried out by a third party proportionate to the increase of the value of the real property after remedial work has been carried out.

The extent of the liability is determined by a reasonableness assessment, whereby the time elapsed since the contamination was caused and other circumstances are taken into consideration.

iii Transfer tax

Stamp duty is charged on the transfer of real estate but not on the transfer of legal entities. The rate is 4.25 per cent of the property's value if the buyer is a legal entity and 1.5 per cent if the buyer is a private person. The value of the property used for the purpose of calculating the stamp duty is the higher of the actual purchase price and the tax assessment value. In the absence of a tax assessment value for a particular property, the value of the property used for the calculation will be the higher of the actual purchase price and the market value according to a valuation of the property. The law stipulates joint and several liability for the buyer and the seller to pay stamp duty, but it is customary to agree contractually that the buyer pays. In the event that the real estate is sold on within three months at the same price and on the same terms, stamp duty will in some cases only be payable for the latter transfer.

iv Finance and security

Security over real property is created in the form of a real property mortgage, which can be issued in any amount regardless of market value of the property at a cost of 2 per cent of the face value of the mortgage. Mortgages on a property have internal priority based on the chronological order in which they have been taken out.

Each mortgage is evidenced by a mortgage certificate, which can be either in physical or electronic form. The mortgage certificate, which is a bearer document that can be used as security until cancelled by the property owner, represents a fraction of the value of the property but is not evidence of indebtedness as such or an existing security interest.

A pledge over the mortgage is perfected when the owner of the property pledges the mortgage certificate as security for a credit or a claim and delivers the mortgage certificate to the pledgee. In the case of bankruptcy or enforcement proceedings, the claim of a mortgage pledgee has priority up to the sum of the amount of the pledged mortgage certificates, plus an additional 15 per cent of the amount of the mortgage certificates plus a certain interest prescribed by law.

VI LEASES OF BUSINESS PREMISES

Chapter 12 of the Land Code (the Act) includes provisions that govern both commercial and residential lease agreements. Some provisions apply only in relation to residential or commercial lease agreements, but several provisions apply to lease agreements in general. Many of the provisions in the Act are mandatory for the protection of the tenant, and it is not possible to deviate from these provisions unless it is to the benefit of the tenant.

i Term and termination

A lease agreement regarding business premises can be entered into either for an indefinite term or for a fixed term. For a lease agreement with an indefinite term, the notice period must be at least nine months, and it is possible to agree a longer termination notice period. For a lease agreement with a fixed term, the length of the term determines how short the termination notice period can be. If the lease term is nine months or longer, the notice period must be at least nine months; accordingly, it is also possible to agree a longer termination notice period.

A lease agreement with an indefinite term must be terminated to expire. The same applies for a lease agreement with a fixed term if the tenancy has continued for more than nine months. Normally, such lease agreements include a clause stipulating that, unless terminated upon expiry at the end of the lease term, the lease agreement is automatically prolonged for another fixed term. Without such a clause, the lease agreements are deemed prolonged for an indefinite term unless terminated to the end of the lease term. A lease agreement with a fixed term cannot be terminated by the landlord prior to the end of the agreed lease term unless the tenancy is forfeited because of, for instance, default in payment of rent.

ii Rent

The rent in a commercial lease shall, as a general rule, be set out as a fixed amount in the lease agreement. This rule does not apply in relation to reimbursement for costs for heating, hot water, electricity or fees for water and sewerage. It is also possible to have a rent that is related to the tenant's turnover.

If the lease agreement is for a fixed term of at least three years, the rent may be calculated on another basis, so the rent does not have to be fixed in advance. For instance, the rent is often adjusted annually based on changes in the Swedish consumer price index. In addition, such lease agreements may include reimbursement clauses for costs other than those set out above, such as costs for property tax and unexpected costs.

iii Tenant liability

The tenant's primary liabilities are to pay rent in a timely manner, to use the premises as stipulated in the lease agreement and to comply with the other provisions in the lease agreement. Failure in these respects may, under certain circumstances, constitute grounds for forfeiture of the lease agreement, entitling the landlord to terminate the lease agreement prematurely and to claim damages. In addition, the tenant has an obligation to look after the premises and to compensate damage caused to the premises by the tenant, persons visiting the tenant or as a consequence of negligent actions by persons carrying out work in the premises on behalf of the tenant. The tenant has an obligation to report damage that occurs in the premises and, if failing to report such damage, may be held liable for resulting damage. Unless otherwise agreed, the landlord is responsible for maintenance of the leased premises.

iv Security of tenure

If the landlord terminates the lease agreement upon expiry at the end of the fixed lease term (or at the end of any following prolongation period), or if the landlord at the expiry of the lease term or any following prolongation period terminates the lease for renegotiation and demands changes (i.e., increased rent) that are not in accordance with market conditions, then the Act provides that the tenant is entitled to compensation from the landlord for damages resulting from the termination of the lease agreement. The minimum compensation is one year's rent. This right to compensation is known as a tenant's indirect right to extension.

Any provision in the lease waiving the indirect right to extension is not enforceable against the tenant. For such a waiver to be enforceable, it must be made in a separate agreement signed by the landlord and the tenant. If made before or within nine months of commencement of the tenancy, the Rent Tribunal must, as a general rule, also approve such waiver.

The tenant's right to compensation does not apply in the event the tenancy is forfeited. The landlord is entitled to repudiate the lease upon the tenant neglecting contractual obligations of exceptional importance for the landlord. Furthermore, the Act stipulates situations in which the tenant is not entitled to compensation following termination by the landlord, even if the tenant has not committed a breach.

v The main characteristics of a typical commercial lease agreement

Most lease agreements regarding business premises in Sweden are based on a template provided by the Swedish Property Federation, prepared in consultation with the Swedish Federation of Trade and the Swedish Hotels and Restaurants Association. Lease agreements are normally entered into for a fixed lease term of three or five years with notice periods of nine or 12 months. Unless terminated, lease agreements are normally automatically prolonged for three or five years at a time. In most lease agreements, the rent is annually adjusted in accordance with changes in the consumer price index. In addition to paying rent, it is common that the tenant has to reimburse the landlord for costs regarding utilities such as heating, water and sewerage, cooling, ventilation and electricity, and for costs regarding property tax. Normally, the tenant is responsible for maintenance of the surfaces of walls, floors and ceiling of the premises. Under normal circumstances, the tenant does not waive its right to compensation upon termination of the lease agreement.

VII DEVELOPMENTS IN PRACTICE

i New Planning and Building Act

The introduction, on 2 May 2011, of the new Planning and Building Act (see Section V, *supra*) is one of the most important changes to Swedish real estate law in recent years. The purpose of the Act was to simplify and clarify the law regulating planning and building. In general, the new Act is similar to the old Act, but it introduces some new measures, including the following:

a Municipalities must now account for conditions that will be imposed in a building permit before the building permit is issued.
b The turnaround time for an application for a building permit is limited to 10 weeks.
c Building permits are to gain legal force so that they cannot be subject to appeal long after they were issued.
d Climate effects are to be taken into account when an application for a building permit is dealt with. If a building has a significant environmental impact, a building permit is not sufficient: a new zoning plan is required.
e Construction works requiring a building permit may not be initiated until the municipality has issued a separate approval.
f Before a building is put to use, a separate approval has to be issued by the municipality. Therefore, the building permit can be viewed, effectively, as a prohibition against the use of a property until such approval has been granted; this must be taken into account when, for example, drafting lease agreements for newly constructed premises.
g Municipalities are required to give individuals who have requested a change of zoning notice of an intention to produce a zoning plan. Such information must be provided within four months of the request.
h Municipalities have been given increased powers to charge individuals for their work with approvals pursuant to the Planning and Building Act.

ii Rent for residential apartments

Until 31 December 2010, rents for residential apartments were determined on the basis of the utility value charged by public housing companies following negotiation with tenants' associations. The utility value system states that apartments of equal utility value should have the same rent levels. As of 1 January 2011, new rules regarding rent levels for residential apartments entered into force. Utility value still forms the basis for determination of rent under the new rules but, when determining the utility value, not only the value of apartments owned by public housing companies is relevant: the rent charged by private housing companies is also used as a comparator. Another change is that public housing companies must be operated in a business-like manner, and not only – as was previously the case – in the public interest. It is hoped that the new rules will result in a small element of market influence on rent levels that will stimulate new construction of residential apartments.

VIII OUTLOOK AND CONCLUSIONS

Some developments relevant to the law and regulation of real estate that have taken place in recent years are summarised below.

i Template 'green' lease agreement

The Swedish Property Federation published a template lease agreement on 1 June 2012 aimed at creating a joint platform for both landlord and tenant to reduce the environmental impact of premises. Since most lease agreements in Sweden are based on templates created by the Swedish Property Federation, the 'green' lease agreement can be expected to have some influence on the content of lease agreements used in Sweden.

ii VAT

Letting of commercial premises is not normally subject to VAT in Sweden. However, it is possible to register premises for voluntary payment of VAT provided that the premises are used by tenants operating a business registered for VAT. As from 1 January 2014, the registration procedure will be simplified and the actual letting of premises to a business that is subject to VAT will be regarded as registration of the premises for letting.

iii Corporate tax rate

As from 1 January 2013, the corporate tax rate on profits has been reduced from 26.3 per cent to 22 per cent.

iv Tax

As from 1 January 2013, restrictions have been introduced for corporate tax interest deductions in respect of loans provided by an affiliated legal entity. Interest on such a loan is not tax deductible if the lender (or beneficial owner of interest, if different) pays less than 10 per cent corporate tax. Interest is deductible, however, if the lender (or beneficial owner) is resident for tax purposes in a jurisdiction within the EEA, or in a jurisdiction that has a double taxation treaty with Sweden of a certain scope, and the loan has been granted principally for business purposes. Even if interest is taxed at 10 per cent (or higher), interest is not deductible if the main reason for the loan provided by the affiliated party is deemed to be tax avoidance.

A parliamentary committee is currently reviewing Swedish corporate taxation in general and further restrictions on tax deductions for interest. The committee will present its proposal in June 2014.

Chapter 35

SWITZERLAND

Cécile Berger Meyer and Andreas Rötheli[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

Swiss real estate law is regulated by the Swiss Civil Code, dated 10 December 1907 (the CC). The relevant provisions are to a very large extent those that entered into force with the CC in 1907; Swiss property law has not undergone any major revision since then – a testament to the system's clarity and efficiency in practice.

Real estate ownership can take any of the three main forms in Switzerland: land ownership, ground lease ownership or condominium-principled ownership.

Land ownership is the most standard form of ownership, and encompasses ownership of the land and its integral parts (i.e., mainly the constructions erected on the relevant plot) in accordance with the accession principle prevailing under Swiss property law.

Ground lease ownership is a form of ownership that enables the owner of a plot to dissociate ownership of the ground from ownership of the constructions erected on the plot. Technically, a ground lease is a long-term easement recorded in the land registry and which entitles its beneficiary to erect and own constructions on the base plot encumbered by such easement. A ground lease may only be registered as a separate entry in the land registry if it has been granted for a minimum duration of 30 years. In such case, it can be sold as a plot to a third party (subject to the consent of the owner of the base plot), and can benefit from and be encumbered by all the various types of easements and other property restrictions permitted under Swiss property law. The most interesting feature of the ground lease is the fact that it is possible for it to be encumbered, as can be done with a standard plot by way of a mortgage, thus permitting its owner to benefit from its enforcement value.

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The ground lease is a form of ownership frequently used for strategic development zones, such as industrial zones in Switzerland's main cities. The canton of Geneva, for example, has made extensive use of this form of ownership by creating six industrial zones composed of 277 ground leases and regulated by special regulations enacted by the state of Geneva in light of the specificities of each such zone. A public foundation, the Foundation for industrial lands in Geneva, is supervising these ground leases and, more generally, the compliance with applicable zoning regulations of the various tenants, owners and occupants of these zones.

Condominium-principled ownership is a form of land ownership by which one right of ownership is owned by a community of owners (as opposed to one owner in the standard land ownership or the ground lease ownership). Condominium-principled ownership is typically used for residential buildings or mixed commercial and residential buildings. It is particularly used in real estate development projects, since it enables the developer to sell the constructed building flat by flat, or unit by unit. Condominium-principled ownership is also used in Geneva to split ground leases into various condominium ownership rights, thus allowing small and medium-sized enterprises to settle down and own their commercial premises.

In rem rights on real estate are validly created only upon their registration in the land registry except in situations when such rights are necessary for technical or financial reasons (pipe easements, etc.), in which case they are binding on good faith acquirers even in the absence of a registration in the land registry. Other than in such exceptional circumstances, *in rem* rights do not exist in the absence of a registration. Accordingly, the land registry provides for exhaustive information on title, easements, mortgages, annotations (pre-emption rights, selling restrictions, artisan legal mortgages) and mentions (restrictions of ownership). Public law restrictions are, however, not registered in the land registry, and so must be part of a separate due diligence process to be performed at federal, cantonal and communal levels (i.e., zoning restrictions, restrictions related to asbestos and polluted sites, construction law restrictions, etc.).

Swiss law does not provide for a state guarantee of title. That said, a buyer is in practice fully protected by law if it has acquired a real estate asset in good faith relying on the information provided by the land registry. A recently certified land registry extract is, therefore, always requested by a buyer before the completion of a real estate transaction to ensure that, at the time of the execution of a sales deed, the plot's situation has not changed (i.e., no additional mortgages or easements have been registered, and the seller still owns the plot); however, if a buyer knows – or should have known – that an entry in the land registry is incorrect, it is not protected by its reliance on the incorrect information or registration. Land registry excerpts are, in some cantons, no longer fully reliable, in that some land registries face important delays (from one or two days up to one or two weeks) in the registration of transactions with the land registry. Indeed, any real estate transaction taking the form of an asset deal in Switzerland must be recorded officially in the land registry through a two-step registration process. The first step simply records the entry in the land register, by mentioning on the relevant plot that a matter is pending, attributing at the same time the order of precedence to the entry. The second step relates to the validation, on the merits, of the first entry. Delays were, until 2012, only encountered at the level of the second stage. Since 2012, however, some cantons, such as Geneva and Vaud, are no longer up to date with the first stage, meaning that a potential buyer, when ordering a land registry excerpt, needs to obtain an additional confirmation from the land registry that, as of the date of the transaction, no pending matter' are yet to be registered on the plot at stake.

Transactions involving real estate are, by default, governed by the law of the place where the property is located; however, a choice of law provision is possible, except in the case that formal requirements are imposed by the law of the place where the property is found. In practice, real estate transactions that take the form of asset deals for Swiss properties are governed by Swiss law, and real estate transactions completed as share deals are subject to the law of either of the parties or to the law of the place of incorporation of the target. Representations and warranties regarding the underlying real estate asset in share deals remain in any event tightly linked to Swiss law, as applicable property and territory allocation regulations are, by nature, those of the place where the property is located.

II OVERVIEW OF REAL ESTATE ACTIVITY

Switzerland's economy held up relatively well in 2013 despite the bad economic situation prevailing in the eurozone. The Swiss real estate market has followed this general trend, although some actors on the real estate sector consider that real estate transactions are taking place at a slightly slower pace than during 2011 and 2012, which were considered to be exceptional years.

The strong Swiss franc has not yet had a major impact on foreign investors who are, by and large, still present and active in the Swiss real estate market; however, some foreign investors did use the strong exchange rates in 2012 and 2013 as an opportunity to exit from some of their investments in Switzerland. The high and unprecedented real estate prices in Switzerland also persuaded some companies to enter into sale and lease-back transactions for their premises. Major properties were acquired not only by foreign investors considering Switzerland's real estate as stable assets suitable for investment without high risk, but also by Swiss institutional investors considering real estate a safe and alternative investment to listed securities. Real estate has become an evident investment trend for both institutional (insurance companies, pension funds, etc.) and private investors seeking stable returns in an environment generally characterised by economic turmoil. Switzerland has consolidated its position in this respect, being regarded more than ever as a country with a stable economic and political situation. Recent major real estate transactions in Switzerland involved mainly Swiss or foreign institutional investors, or both.

In respect to residential buildings, some actors of the real estate market have seen a drop in the number of transactions in 2013, likely as a result, *inter alia*, of the current high prices in this sector. These actors further confirm that a small drop in prices could be seen in 2013. In touristic regions, the legal uncertainties resulting from the acceptance of the Weber Initiative in March 2012 have restrained certain investors from completing their contemplated holiday home acquisition, or have considerably extended the time to complete a real estate transaction (see Section VIII, *infra*). Other actors confirm to the contrary that real estate prices for residential properties increased last year. All actors, however, confirm that Switzerland has probably hit its maximum prices.

In respect to transactions pertaining to commercial buildings, some Swiss real estate funds and unit trusts seem to be facing a downward trend, resulting in a slight decrease of trade price of such funds' shares.

Collective real estate investment vehicles have been set up in the form of either closed or open-ended real estate funds, generally listed on the Swiss stock exchange. While some of the funds' shares are traded with premiums of over 20 per cent, others face a downward trend (trading prices below the fund's net inventory value), especially due to the lack of confidence of some investors. Nonetheless, during the first half of 2013, the cumulated net assets managed by Swiss real estate funds and unit trusts increased by approximately 3 per cent, while the average return on investment decreased slightly by approximately 0.08 per cent.

The high demand for holiday homes has led some cantonal and communal legislative bodies to adopt regulations aiming at a rational allocation of main residences and holiday homes. In addition, an initiative to introduce a ban on the construction of new second homes in communes that have exceeded the threshold of 20 per cent of secondary residences (see Section VIII, *infra*) was accepted on 11 March 2012 by a majority of Swiss voters and backed by a majority of the Swiss cantons. This result was an unexpected and major success for Franz Weber, a political figure in Switzerland famous for campaigning to conserve the Swiss landscape.

i New minimum standards for mortgage loans

The Swiss Banker's Association enacted new minimum standards applying to real estate financings granted by banks in Switzerland in June 2012. These new standards, which entered into force on 1 July 2012, provide for minimum requirements in terms of equity and amortisation to be applied to all real estate financing granted by banks in Switzerland for Swiss real estate to ensure that an increase in interest rates does not lead to a major economic crisis resulting from defaults under Swiss mortgage financings.

The new standards oblige borrowers to pay, in cash, and from their own funds, a minimum of 10 per cent of the value of the property, thus implying that the practice allowed until 1 July 2012, whereby residents seeking to buy their own home could – to meet the 20/80 debt equity ratio prevailing in Switzerland – pledge their pension fund (called pillar 2 assets in the Swiss pension fund regime) in replacement of their 20 per cent equity down payment. This is now no longer possible, and all persons (or companies) seeking mortgage financings over Swiss real estate from a bank practicing in Switzerland must, since 1 July 2012, make a 10 per cent minimum down payment in cash. The new standards further require borrowers to amortise their mortgage financings down to two-thirds of the value of the financed property within 20 years from the day of financing.

In addition to these new minimum standards, on 13 February 2013, the Swiss Federal Council, at the request of the Swiss National Bank (the SNB), partially activated the countercyclical capital buffer (the CCB), taking effect on 30 September 2013.

Based on the Ordinance on Capital Adequacy and Risk Diversification for Banks and Securities Traders, the SNB may request the Swiss Federal Council to require banks to hold, in the form of hard core capital, a capital buffer of up to 2.5 per cent of their Swiss risk-weighted assets.

The activation of the CCB by the SNB results from the SNB's assessment that the growth in mortgage loans and real estate prices over the past few years was so strong that it may affect the stability of the overall Swiss banking sector, and hence the Swiss economy more generally. The SNB intends in that context to counter a potential instability in the Swiss economy resulting from an increase in the interest rates in the future.

As a result of the above, the Swiss Federal Council resolved on 13 February 2013 to activate the CCB, currently amounting to 1 per cent of the risk-weighted, direct or indirect mortgage-backed positions secured by residential property located in Switzerland. The deadline for compliance with the CCB had been set as 30 September 2013. It was estimated that mortgage loans of 600 to 650 billion Swiss francs were involved, thus meaning that additional equity capital of approximately 3 billion Swiss francs is necessary to meet the new requirements.

Real estate market players do not expect the CCB to have a major influence on real estate prices or on the real estate market in general, but may lead certain banks to refrain from granting additional mortgage loan financings given the additional capital equity to be issued by the bank as a result of the CCB. The CCB has been heavily criticised in the real estate sector, as it is considered to be an inadequate measure to fight against an non-existent threat in the Swiss economy.

The SNB and the Swiss Federal Council may further adapt the level of the CCB in the future, as the above-mentioned 1 per cent rate is not the maximum allowed under the applicable regulations. The evolution of the CCB should thus be carefully monitored in the future, as it may have an impact on the evolution of the Swiss real estate market.

III FOREIGN INVESTMENT

Overseas investors are mainly restricted in real estate ownership as a result of the federal statute on the acquisition of real estate by foreigners (the Lex Koller).

As a matter of principle, the Lex Koller restricts the acquisition of residential real estate in Switzerland. Despite its liberalisation in 1997 and 2002, the Lex Koller remains fully applicable today. Politicians launched an initiative to abolish it between 2005 and 2006; its abrogation was, however, refused by Parliament in 2008, and the Swiss Federal Council issued a release on 13 November 2013 in which it recommends that the Parliament renounce the abrogation of the Lex Koller. It should finally be noted that the Lex Koller has recently been amended to adapt it to real estate funds (and investment funds and unit trusts) (see Section VIII, *infra*).

The 1997 and 2002 Lex Koller revisions considerably opened up Switzerland's commercial real estate market to foreign investors. The residential real estate market, however, remains heavily restricted.

Determining whether the Lex Koller applies to a property is, therefore, important, as commercial properties can be acquired with no (or few) restrictions, while residential properties can only be acquired if an authorisation is issued. In practice, authorisations to acquire residential properties are granted on very limited grounds. Restrictions affecting real estate assets used for commercial purposes concern commercial premises that are empty, that contain residential parts or areas, or that are acquired in anticipation of a company's expansion in the short or medium term (but with no concrete plans to build at the time of the acquisition).

In practice, holding companies often face a situation in which a company owns, as part of its assets, one or two residential buildings. Some cantons allow a company, whose purpose is an operational one (e.g., to run an industrial plant or a hotel) to own, among its assets, up to 30 per cent of non-commercial (residential) real estate assets. The reference value for calculating this 30 per cent threshold is the market value of the real estate asset. Applied to holding companies, the 30 per cent threshold is calculated on a consolidated basis, that is, on all real estate assets owned by the holding company's subsidiaries. Since cantons are entrusted with the responsibility and power to apply and ensure compliance with the Lex Koller, the local practice must be checked prior to every transaction.

The Lex Koller also limits mortgage financings granted by foreign investors or banks. Foreign mortgage financings are usually limited to 80 per cent of the value of the underlying residential real estate assets; however, the financing of commercial real estate assets is not limited as, since 2002, this type of real estate is no longer encompassed by the Lex Koller restrictions. The foreign mortgage financings limit varies from canton to canton, with some cantons applying instead a threshold of two-thirds of the value. Local practice must, therefore, be checked prior to any foreign mortgage financing transaction.

IV STRUCTURING THE INVESTMENT

i Investment vehicles and structures

Real estate investments are mainly made via collective investment funds or standard special purpose vehicles (SPVs). The acquisition of main or secondary residences for own use, as opposed to the acquisition of real estate for investment purposes (i.e., rented commercial or residential premises), is usually done in the name of the future owner, particularly given that the Lex Koller restrictions do not allow foreigners to acquire their main or secondary residence through a special purpose vehicle.

Collective investment funds are becoming extremely popular in Switzerland, whether in the form of traditional investment funds or unit trusts (SICAVs).

Swiss real estate investment funds or SICAVs are usually listed on the Swiss stock exchange, allowing them to benefit from certain simplifications for Lex Koller purposes. They most often acquire their properties by way of asset deals, as opposed to acquiring shares of real estate companies (each owning a single or a few properties).

Foreign investment funds may only acquire commercial real estate, so they usually acquire Swiss properties via Swiss or foreign SPVs. Tax considerations usually determine the structure of foreign investment funds, depending on which double taxation treaty with Switzerland applies.

Local investors usually acquire real estate directly in their own name, or in a business capacity via SPVs commonly known as real estate companies. The choice between acquiring property through a share deal or an asset deal largely depends on the type of property and the projects contemplated for the property.

ii Tax aspects

Real estate transactions trigger taxes payable by both seller and buyer, and authorities have a legal lien on the property for the amount of these (unpaid) taxes. Such a legal lien, provided it relates to tax periods after 1 January 2012, must be registered in the land registry within two years to be valid and enforceable against a new owner of the plot. Taxes dating back to tax periods before 1 January 2012 are, however, subject to the old regime: they are protected by a legal lien that does not have to be registered in the land registry to be valid and enforceable. Taxes so triggered determine the structuring of the real estate transaction.

At the federal income tax level, gains realised by the disposal of real estate property that was a business asset are taxable. Gains realised on the disposal of real estate belonging to an individual who held the real estate as a private asset are exempt from income tax; however, gains of professional real estate dealers are subject to federal income tax.

At the cantonal income or capital gains tax level, the disposal of real estate is subject to income or capital gains tax. It is, in principle, levied on the difference between the base cost and the purchase price, that is, the gain from the sale of the real estate, and is payable by the seller. The tax rate depends on cantonal legislation, the gain and the period of ownership. Capital gains tax might be deferred if an owner-occupied property is sold and the revenue from the sale is reinvested within an adequate period for the purchase or building of a replacement property.

The acquisition and disposal of real estate is exempt from value added tax (VAT). The seller may, however, under certain conditions, opt to pay VAT on the transfer of business premises to a buyer who is also subject to VAT. If it is payable on a particular transfer of real estate, it is paid by the seller (unless the obligation can be notified to the authorities by a notification procedure). The current standard rate is 8 per cent of the purchase price of the real estate less the value of the land.

A VAT option allows the owner of the plot to recoup VAT paid on construction costs and is, therefore, often chosen for newly constructed or recently refurbished buildings. The owner must, as a result, submit all its leases and rent payments for VAT to avoid any VAT self-assessment procedure.

V REAL ESTATE OWNERSHIP

i Planning

Planning control is governed by the federal law on planning, which is implemented by each canton and commune according to the same general principles.

Each canton adopts its general allocation plan, which is then further implemented by each commune through communal allocation plans.

Communes may further impose additional planning requirements for construction in excess of certain areas or located in certain zones. Geneva regulations, for instance, provide for the requirement to have a local plan adopted for any important constructions located in a development zone. Some communes further impose a requirement to adopt a local allocation plan, completing the communal allocation plan for areas with particular characteristics (e.g., lakeside plots).

Change of use is becoming heavily regulated and subject to increasing restrictions because of the small size of the Swiss territory. Switzerland's most dynamic regions face an increasing lack of housing accommodation, and have consequently enacted laws restricting changes of use and communal allocation plans to ensure that housing accommodation is included in any new construction.

Geneva, therefore, prohibits any change of use of residential premises into commercial premises unless such change of use is compensated for by a simultaneous creation of new residential premises (same type, surface and quality) in the same neighbourhood. Geneva further enacted a ground-use plan that entered into force in 2010, and which provides that any newly built area must contain a minimum of 50 per cent and a maximum of 80 per cent of housing accommodation.

Some cantons also restrict the use of industrial zones by prohibiting administrative use of premises in favour of small to medium-sized industrial companies and craft industries. Geneva faces major restrictions in this respect and, given the tight market, new companies requiring important administrative premises encounter increasing difficulties in finding premises to meet current and future (expansion) needs.

ii Environment

Contaminated land is dealt with in the Swiss environmental statute and its implementing ordinances. Contaminated sites must as a matter of principle be cleaned up if they cause significant harm to the environment or if there is a concrete danger that such harm may appear.

The law distinguishes between the performance of the measures relating to the cleanup and the bearing of the costs. Investigations, as well as monitoring and cleanup measures, must be carried out by the holder of the site, who must provide advance payment for such measures. The final bearing of the costs is then determined by an allocation-of-costs proceeding, which aims to identify which person or entity caused the contamination through its behaviour (troublemaker by behaviour). In situations where more than one person or entity appear as troublemakers by behaviour, each will be held liable in proportion to its respective liability. The holder of the site (troublemaker by situation) will in such instance only have a residual liability.

Concerned parties may also come to an agreement as to how liability should be allocated between themselves. Private law arrangements, however, may not supersede any decision on allocation of environmental costs issued by a competent authority. As a result, such agreements only have an impact on the parties' internal relationships.

iii Tax

Most cantons (and municipalities) levy a real estate transfer tax payable upon each transfer of ownership.

The respective real estate transfer tax rates vary by canton, and are usually between 1 per cent and 4 per cent of the purchase price or the taxable value of the real estate. There are exemptions from, or reductions of, transfer tax for specific real estate transfers in cases such as reorganisations, expropriations, compulsory auctions and transfers between relatives or investment funds (subject to advanced tax rulings).

In principle, the buyer is liable for the transfer tax; however, in some cantons, transfer taxes are split between the buyer and the seller.

There is no transfer tax triggered in a share deal of a company owning real estate if the legal owner who is registered in the land registry remains the same, unless the company qualifies as a real estate company. Most cantons qualify a company as a real estate company if most of its assets are real estate or if its profits are mainly made from real estate transactions.

In addition to such taxes, notary fees and land registry fees are due in asset deals. Who pays such fees mainly depends on local practice and the contract between the parties. In some cantons (e.g., Geneva), the buyer usually bears all the fees. In others, the buyer and seller share the fees equally.

iv Finance and security

Real estate financing is usually subject to the assignment of mortgage certificates for security purposes and to the assignment of rental income claims for security purposes.

Security interests by way of transfer of ownership on mortgage certificates for security purposes are extremely frequent in practice. In Switzerland, however, issuance of mortgage certificates is costly, since, in most cantons, transfer tax is levied on their creation at a rate of 1 per cent to 2 per cent of the face value of the certificate. The security interest is perfected by execution of a written deed of assignment and delivery of the mortgage certificate. Using dematerialised mortgage certificates, the delivery of the securities is replaced by a registration of the new secured creditor with the land registry.

Assignment of rental claims, insurance claims and bank account claims usually completes the assignment of mortgages for security purposes. Security agreements typically provide that insurance companies and banks may be notified immediately of the assignment, while tenants may only be notified of the assignment upon the occurrence of an event of default.

VI LEASES OF BUSINESS PREMISES

Switzerland's lease agreements are governed by specific rules in the Swiss Code of Obligations, which are highly favourable to tenants and for which no derogations are permitted. Negotiations on lease agreements are therefore limited to non-mandatory provisions of the Code of Obligations. Lease disputes are treated by specific courts, which exclusively decide on lease matters and are composed of three judges, among which one will defend the interests of tenants and another the interests of landlords.

Leases for commercial premises are usually entered into for five-year periods, to allow the landlord to adapt the agreed rent to the consumer price index. Indexation can only be done under Swiss law for leases of a minimum duration of five years. Rent increases can only be effected at the end of the agreed term unless specific provisions allowing for intermediary increases have been agreed. Parties may, for instance, agree to a staggered rent, or to increase the rent should the landlord carry out added-value works in the rented premises during the course of the lease.

Various types of options may then be agreed between the parties. Real options are often requested by the tenant, while landlords prefer having unreal options, as such options allow them to break the lease at the end of a five-year period and rent the premises at the new market price.

Swiss lease law provides tenants with an array of protective measures. Tenants may, for example, challenge their initial rent within 30 days from the date on which they moved into the premises. Tenants may further challenge any additional rent increase in the future as well as the termination of their rental agreement. These rights of challenge trigger many court precedents in practice, and give a Swiss lease a very strict and formal framework that strongly limits a landlord's rights.

Swiss law does not have a security of tenure right. Nonetheless, tenants of commercial properties may seek an extension of their lease by a maximum of six years (in one or two extensions) in situations where the termination of their lease would cause them to suffer hardship.

VII DEVELOPMENTS IN PRACTICE

i Adaptation of the Lex Koller to the new form of collective investment schemes

As a result of the entry into force of the federal statute on collective investment schemes of 23 June 2006, which especially creates various new collective investment schemes, the Lex Koller has been slightly adapted to determine how these new vehicles (such as real estate funds, investments funds and unit trusts) should be treated in respect to foreign investors.

The new regulation, effective as of 1 Mars 2013, especially provides that real estate funds are presumed to be controlled by persons abroad if their management is exercised through persons abroad and if the fund management company further qualifies as a person abroad (as defined in the Lex Koller).

In respect to unit trusts (SICAV), the new regulation also provides that control by persons abroad is presumed in the event persons abroad own more than one-third of the voting rights related to the entrepreneurial share capital (as opposed to the investor share capital), if they represent the majority of the members of the board of directors, or if they lend more than 50 per cent of the difference between the total assets of the entrepreneurial share capital of the unit trusts and the total debts of the latter towards persons that are not subject to a Lex Koller authorisation. The legislator mainly focuses on the company share capital (as opposed to the investor share capital), thus resulting in a greater flexibility in respect to the identity of the investor shareholders (Swiss or foreign).

ii Implementation of the Weber Initiative protecting the Swiss landscape

On 11 March 2012, the Swiss population accepted by a narrow majority the popular initiative launched by Franz Weber, Stop the Boundless Construction of Second Homes (the Weber Initiative).

The Weber Initiative added two new provisions to the Constitution. The first restricts the construction of second homes to 20 per cent of the homes and the gross floor area of each Swiss commune. The second provides that construction permits for second homes shall automatically be null and void if they are issued between 1 January 2013 and the date of entry into force of the implementing federal statute. The potential impact of the Weber Initiative in practice is important, particularly in touristic areas of the country where the 20 per cent threshold has already been exceeded (i.e., mainly in Switzerland's famous Alpine ski resorts), as no new second homes should be allowed in the future in communes where the 20 per cent threshold has been exceeded. The provisions raise numerous legal questions that will be extremely difficult to solve in the future.

Between 11 March 2012 and 31 December 2012, communes issued numerous construction permits, making the best of the time gap existing between 11 March 2012 and the 1 January 2013 deadline included in the Weber Initiative. The Weber Initiative's committee strongly criticised the delivery of these new construction permits during this time frame, and filed numerous appeals against such permits. The Swiss Supreme Court issued three key decisions on 22 May 2013, and ruled in favour of the Weber Initiative's committee: it decided that the new constitutional provisions had already entered into force on 11 March 2012, and accordingly cancelled all the construction permits issued between 11 March 2012 and 31 December 2012 in communes where the 20 per cent threshold of second homes is considered as already exceeded, and for which an appeal had been filed by the Weber Initiative's committee. Construction permits for which no appeal was filed have, however, entered in force, and we have not yet heard of any court decision considering that using these permits constitutes an abuse of right or is illegal.

Given the complexity of the matter, and in anticipation of the adoption of the implementing federal statute regulating the legal situation in greater detail, a temporary ordinance has been passed that entered into force on 1 January 2013 and that aims to clarify the legal situation until the enactment of the formal implementing statute of the Weber Initiative.

In summary, the temporary implementing ordinance provides that in municipalities with a second-home quota of over 20 per cent, construction permits for new second homes shall no longer be granted as of 1 January 2013 until the implementing statute has been passed, when the provisions of the implementing statute will exclusively govern the matter. The ordinance provides, however, for certain exceptions. In particular, despite a second-home quota exceeding 20 per cent, construction permits may be granted if the respective object is considered as a 'qualified second home' managed in a 'qualified touristic manner', and it is offered in the context of structured forms of accommodation (e.g., apartment-hotels, which the owner may not use personally for more than three weeks in peak seasons), or its owner is living in the same house and the second home is not fitted out individually.

The first draft of the implementing federal statute (along with its ordinance) was made available for consultation on 26 June 2013. All interested parties had the opportunity to review and comment on this draft version until 20 October 2013. The analysis and interpretation of the results are still ongoing, but are expected shortly.

The implementing federal statute provides that in municipalities with a second-home quota of over 20 per cent, construction permits for new second homes shall no longer be granted. In line with the temporary ordinance, the federal statute also provides for certain exceptions. It especially indicates that construction permits may be granted despite a second-home quota exceeding 20 per cent as long as the new homes are allocated for touristic accommodations (implying an obligation to offer such homes for rent in the market at market terms on a long-term basis for short-term stays, in particular during peak seasons) and provided at least one of the following conditions is met: its owner is living in the same house, it is offered in the context of structured forms of accommodation (e.g., hotel accommodation) or it is offered on a commercial platform intended for the international market.

In respect to housing accommodations built before 11 March 2012 (i.e., before the entry into force of the constitutional provisions related to second homes), the first draft of the implementing federal statute offers two alternatives: the first offers a great deal of flexibility, insofar as it provides that such housing accommodations may freely be used (as primary or second homes) and may be subject to minor extensions. The second, however, provides that housing accommodations created under former applicable law may only be altered within the limits of their existing surface. It further stipulates that changes of allocation (from main residence to second home) are only permitted for restrictive causes (such as death, change in marital status, etc.).

On one hand, the Weber Initiative's committee strongly displayed its displeasure regarding the first draft of the implementing federal statute: it believes that the essence of the initiative has not been complied with, as the federal statute offers too many opportunities to bypass the 20 per cent second home threshold. On the other, many economic circles – as well as real estate owners in touristic areas – especially welcomed the first alternative due to its flexibility.

However, in our view it is unfortunate that the first draft of the implementing federal statute has not yet been coordinated with the Lex Koller, thus implying the existence of two separate parallel procedures before two different authorities; and that the issue regarding the change of allocation of commercial premises into housing accommodations has not been properly dealt with, such that – for example – one may currently not say whether the change of allocation of a restaurant into housing accommodation will result in the possible creation of a main residence only, or potentially also a new second home. Notwithstanding the above, we believe that the new opportunity to create new homes, provided they are offered on a commercial platform for the international market, is highly positive, especially for the development of various Swiss touristic areas.

VIII OUTLOOK AND CONCLUSIONS

Territory allocation regulations in Switzerland underwent some important changes in 2013, and other major changes are expected in future years as a consequence of Switzerland's small size and its important growth during the past decade.

Given the continuous economic growth of the country, the Swiss territory and its management, in the short and long term, is still a priority of the main political parties, who aim to protect the landscape and ensure that Switzerland's economy is given the right tools to pursue its economic growth.

In two respects, 2013 was an important year in the area of law: first, the initial draft of the federal statute implementing the Weber Initiative was issued and highly debated by many interested circles: the new version of the implementing federal statute is awaited with great interest in 2014.

Secondly, on 3 March 2013, the Swiss, by a large majority (62.9 per cent), accepted the new provisions in the federal statute on territory allocation enacted by Parliament on 15 June 2012.

To implement the above-mentioned new provisions, which will likely enter into force in the spring of 2014, the ordinance on territory allocation will be amended. The implementing revised ordinance on territory allocation, together with the technical guidelines on building zones and the complement to the master planning guide, have thus been made available for consultation until 30 November 2013. These documents have been highly criticised by various interested circles due to the stringent restrictions on the autonomy of the communes and cantons in relation to territory allocation. The analysis and interpretation of the comments and critics are still ongoing, and we believe they will tend towards a partial reinstatement of the communes' and cantons' autonomy.

The new provisions especially seek to limit land available for development in Switzerland to the equivalent needed for each canton and commune for the next 15 years (implying an obligation in non-development areas to rezone or de-zone undeveloped plots considered to be unnecessary for development purposes within the next 15 years); to ensure that, to the extent possible, poorly located building zones are moved to areas where they are needed; and to reduce oversized building zones.

The cantons are required to adapt their master plans within five years of the entry into force of the new provisions in the federal statute. The new provisions further provide that, until approval of a canton's amended master plan by the Swiss Federal Council, the surface of the building zone in the relevant canton should not be increased. The ordinance, however, authorises the cantons with oversized building zones to create new building zones, provided such surface is compensated with a similar surface of (poorly located) existing building zone.

This recent evolution should lead landowners (of land not yet built upon) to determine soon whether development projects may be undertaken to safeguard the existing building rights on the plot and enhance their position in the context of a future rezoning or de-zoning.

As a result of the above, we anticipate that many landowners will develop their land in the next few years to limit the risk of it being rezoned as a non-development area.

Chapter 36

TAIWAN

Yi-Jiun Su and Doris Lin[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

Under Taiwanese law,[2] an individual or an entity may, individually or jointly with others, own freehold title to real property; however, certain categories of land can only be owned by the government, including:

a land lying within a certain distance of the coast;
b naturally formed lakes that are needed for public use and the land within a certain distance of those lakes;
c navigable waterways and the land within a certain distance of these waterways;
d waterways and lakes within city and town areas, and the land within a certain distance of the waterway banks or lake shores;
e public thoroughfares;
f land with mineral springs;
g land with waterfalls;
h land with water sources for public use; and
i scenic spots and historic remains.

ii System of registration

Registration is required to establish title to real property.[3] To obtain a lawful title to a newly constructed building, the owner must file an application with the land office for an inspection of the building before obtaining an occupancy permit. After the inspection

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2 An English translation of the Land Act and other relevant laws can be found on the online database of the Ministry of Justice at http://law.moj.gov.tw/eng/Law/LawSearchLaw.aspx.
3 Article 758 of the Civil Code.

is completed, the occupancy permit is obtained and a survey map is issued, the owner must register its ownership with the land office,[4] which will then issue a title deed (i.e., ownership certificate) of the building to the owner.

Changes in ownership of real property in Taiwan will not take effect until the changes are registered with the land office. In other words, a purchaser will not be the legal owner of the real property until the registration with the land office is completed. Upon application for title transfer jointly filed by the seller and the purchaser, the land office will retrieve the title deed held by the seller. Upon completion of registration, the land office will issue a new title deed to the new owner. Encumbrances (e.g., mortgages) created over real property will not take effect unless they are registered with the land office, in which case relevant documents, including the title deed of the mortgaged property, must be submitted. All registered particulars (except for protected identifiable personal information) are accessible to the public on the online database of the land office. To make transaction prices of real estate more transparent and accessible to the public, effective on 1 August 2012, the Ministry of the Interior (the MOI) established a registration system under which the purchaser, land administration agent (i.e., scrivener) or broker of a given real property transaction must register the actual transaction price of real estate within 30 days of the completion of the title transfer.

iii Choice of law

Theoretically, foreign law can be recognised as the governing law for transactions involving real property in Taiwan by Taiwanese courts, provided the relevant provisions of such foreign law and the consequences of their application are not found to contravene public policy or good morals. Nonetheless, as Taiwanese law requires all matters related to rights and interest in, or partition or division of, real property to be subject to the jurisdiction of the court where the real property is located, in order to avoid any conflict-of-law issues it would be advisable for parties to such transactions to adopt Taiwanese law as the governing law of their contracts.

II OVERVIEW OF REAL ESTATE ACTIVITY

Although property ownership in Taiwan is mainly freehold, long-term leaseholds are becoming more common, particularly in Taipei City and for government build-operate-transfer infrastructure projects, where a right of *superficies* is granted to project companies qualified under the Act for Promotion of Private Participation in Infrastructure Projects (the PPP Act). The PPP Act provides preferential tax and financing treatments for investors of infrastructure projects. In addition, under the PPP Act, the government may assist investors in acquiring land necessary for infrastructure projects.

4 Articles 78 and 79 of the Regulations Governing Land Registration.

Generally, leasehold titles, except for leasehold of land for constructing buildings, are valid for up to 20 years; however, rights of *superficies* over state-owned land can be valid for up to 70 years.[5] Renewal options depend on the contract terms.

Strata titles are fairly common in large urban properties. The Regulations on Management of Apartment Buildings were introduced in June 1995 to standardise building management and maintenance practices. Taiwan has a strata title system under which one may own real property jointly with others but still have proportionate ownership rights, *pro rata* to one's share of the real property, and may transfer such rights without the consent of the other co-owners.

Taiwan's real property market, whether commercial or residential, has been booming for the past few years, primarily as a result of the improved relations between Taiwan and mainland China,[6] low interest rates and increased loan availability. Despite the introduction of a special tax (discussed in detail in Section IV, *infra*) and other anti-speculative measures, particularly the compulsory registrations of and public access to the actual transaction prices of real property implemented by the MOI starting from 1 August 2012 (see Section I, *supra*), to cool down the residential property market, housing prices continue to surge. Addressing the problems arising from uneven supply and demand in the real property market has thus become a major challenge for the government.

III FOREIGN INVESTMENT

In Taiwan, foreign investment is mainly regulated by the Statute for Investment by Foreign Nationals and the Statute for Investment by Overseas Chinese. Both statutes allow foreign-invested entities and foreign individuals to receive the same regulatory treatment as local companies and individuals. Compared with 10 years ago, foreign investors now face fewer restrictions investing in real property in Taiwan;[7] nowadays, they can buy real property in Taiwan subject to prior government approval, which is granted in most cases.

The available investment structures have evolved over the years, with many forms of ownership such as sole ownership, co-ownership, ownership through a sale and leaseback, and investment trust, to name a few. The investment structure adopted varies from one investor to another, depending on their business needs, tax planning and investment objectives. There are three major groups of foreign investors in the real property market: individual investors, corporate investors and institutional investors. Corporate investors purchase real property mainly to meet their operational needs,

5 Article 5 of the Measures on Creation of *Superficies* over State-Owned Not for Public Use Land, last amended on 13 September 2012.

6 The Economic Cooperation Framework Agreement was signed on 29 June 2010. The agreement is seen as a historic breakthrough in the relations between Taiwan and mainland China.

7 On 15 November 2001, the Measures Governing Foreigners' Procurement of Rights in Domestic Land were substantially amended to relax restrictions on foreign investment in real property.

while institutional investors purchase real property for capital gains and rental income. They can both invest in real property in Taiwan in one of two ways. First, in a case of ownership through a subsidiary, a foreign entity may purchase real property in Taiwan through a Taiwanese subsidiary. By so doing, the foreign entity may indirectly own real property in Taiwan through holding equity interest in a Taiwanese company that directly owns the real property. As the subsidiary is regarded as a Taiwanese entity, it can avoid the legal requirements applicable to a foreign entity when purchasing real property in Taiwan, discussed in detail below.

In a case of ownership through a branch, a foreign entity may purchase real property in Taiwan through its branch.[8] Unlike a subsidiary, however, a branch, being an extension of the foreign entity's head office, is not considered a Taiwanese entity; hence, the foreign entity, despite having established a branch, must meet the following conditions to qualify to purchase real property in Taiwan:

a the jurisdiction where the foreign entity was incorporated allows Taiwanese entities and individuals to own real property there (reciprocal treatment);

b the real property to be purchased is not restricted land;[9]

c the real property is purchased for its own use, investment or public interest, and is used as a:
- residence;
- place of business, office building, shop or factory;
- church;
- hospital;
- school for children of foreign nationals;
- diplomatic and consular building or office buildings of organisations for the promotion of public welfare;
- cemetery; or
- construction recognised and approved by the authorities as important to Taiwan's major infrastructure, economy, or agricultural or husbandry industry; and

d prior approval from the city or county government with jurisdiction over the real property has been obtained.

In general, the approval mentioned in condition (d) can be obtained within around 14 days of the government's receipt of the application, as long as conditions (a) to (c) have been met. Any subsequent change in the ownership or use of the real property purchased under the second of these options requires prior approval from the city or county government.

8 The foreign entity must be recognised and establish a branch in Taiwan in accordance with the Company Act before being duly registered as the owner of the real property.

9 The term restricted land means the following: forest land, fishing grounds, hunting grounds, salt fields, land with mineral deposits, sources of water supply, land with fortresses or other military establishments, or land adjacent to national frontiers.

Either of the foregoing options may enable a foreign entity to hold real property in Taiwan; however, as the two options have different tax implications, most foreign investors seek advice from local counsel and tax advisers to carefully weigh their choice of investment structure.

Regarding Chinese investors,[10] because of the political tensions across the Taiwan Strait, Chinese investment in Taiwan's real property market was prohibited prior to 2002. Although most regulatory restrictions were relaxed in 2010, Chinese investors are still subject to more legal hurdles than their foreign counterparts. On 26 November 2013, the MOI promulgated certain control measures aimed at controlling the total volume of Chinese individuals' investment in real estate. For Chinese individuals intending to purchase real estate in Taiwan, such Chinese individuals as a whole (i.e., in total) may purchase land of up to a total area of 13 hectares and up to a total of 400 buildings per year. However, the total overall purchases made by Chinese individuals shall not, at any given time, exceed a land area of 1,300 hectares and 20,000 buildings. Although such control measures do not apply to Chinese-entity investors, there has been speculation that the MOI may soon limit the volume of real property in Taiwan that may be owned by Chinese-entity investors engaging in tourism or industrial businesses, which are the most bullish industries in Taiwan and awash with Chinese investment.

IV STRUCTURING THE INVESTMENT

i Subsidiary versus branch

While the time, money and procedure required to establish a subsidiary are similar to those for establishing a branch, these two investment structures may differ in many ways.

Limit on liability

The liability of a subsidiary is limited to the amount of capital contributed by the shareholders, while that of a branch will be extended to the foreign head office.

Tax implications

A subsidiary must set aside 10 per cent of its annual after-tax profit as legal reserve prior to distribution of profit. In addition, any expatriation of dividends to foreign shareholders is subject to a 20 per cent withholding income tax (unless a tax treaty provides a lower withholding rate). Neither of these two requirements applies to a branch.

Corporate governance

A subsidiary must hold a shareholders' meeting at least once a year (or a board meeting if it is a single-shareholder company); a branch need not do so.

10 Legal entities in which Chinese investors hold 30 per cent or more of the total shares, or that are controlled directly or indirectly by Chinese individuals or entities, are considered Chinese entities. Their investments in Taiwan are limited to certain businesses.

Eligibility to purchase real property

As discussed in Section III, *supra*, a subsidiary, being considered a local entity, need not meet the four conditions in the second option (ownership through a branch).

Disposal of real property

Owning real property through a subsidiary may have more flexibility in terms of disposal, because the foreign parent company may choose to have the Taiwanese subsidiary sell the real property, or sell its shares in the Taiwanese subsidiary. There is also a third disposal method for institutional investors who indirectly own a Taiwanese subsidiary through a holding company set up in a third jurisdiction. These institutional investors can dispose of their real property in Taiwan by selling the shares in the holding company; for a branch, the foreign entity may only sell the real property.

As tax implications are usually a major concern of foreign investors, ownership through a branch is a more popular investment structure, in particular, for institutional investors whose investment objectives are for capital gains and rental income, despite the limited choices on how to dispose of the real property.

ii Property transfer versus share transfer

As discussed above, to dispose of the real property, foreign entities may have the owner of the property sell the real property (a property transfer) or sell the shares in the owner (a share transfer). These two transactions carry different tax implications.

Property transfer

For a property transfer, certain transfer taxes, including corporate income tax (17 per cent of the net income), land value incremental tax (LVIT) (ranging from 20 per cent to 40 per cent based on the increase in the land value during the period from the purchase to the subsequent sale) and value added tax on building and stamp duty, will be incurred. In practice, the seller and the purchaser would retain a scrivener to calculate the relevant transfer taxes and fees to ascertain the possible transaction costs before signing a formal agreement.

In addition to transfer taxes, a special property tax will be incurred, which is payable by the seller according to the Statute for Selective Commodities and Services Tax, which took effect on 1 June 2011. This special tax, which is better known as the luxury tax, is levied on a transfer of real property (including a building and the land on which the building is located; and urban land for which a building permit can be issued) at 15 per cent of the sale price if the property is sold within the first year of purchase, and at 10 per cent if the property is sold in the second year of purchase.

Share transfer

The tax implications of a share transfer are less complicated. For a subsidiary of a foreign parent company, the transaction is only subject to a securities transaction tax at 0.3 per cent of the sale price, and any capital gains generated from the transaction are not taxable; however, the capital gains, if any, will be included in the calculation of the basic income and may be subject to an alternative minimum tax under the Income Basic Tax Act. The threshold and tax rate are NT$2 million and 10 per cent of net income. If the alternative minimum tax exceeds the regular income tax calculated in accordance with the Income Tax Act, the difference will be payable as tax.

The transfer of the shares in a foreign entity will not trigger any tax liability in Taiwan.

V REAL ESTATE OWNERSHIP

i Planning

The use of real property is subject to applicable zoning rules. A developer must obtain a building permit before constructing buildings, and an occupancy permit before occupying or using the buildings. The permitted uses of each unit of the building will be stated on the occupancy permit, and any change to such permitted uses requires prior written approval from the authorities. Therefore, an investor should check the zoning of the real property it plans to purchase and the permitted uses of the building located there to confirm whether the target real property can be used for the intended purposes. The zoning information can be obtained as long as the lot number of the land is available to the investor. The owner can be asked to provide the occupancy permit.

ii Environment

The use of land should comply with applicable environmental laws and regulations. If the activities carried out on the land fall within the scope prescribed by the authorities (usually relating to those industries potentially and most likely to cause pollution) pursuant to the Soil and Groundwater Pollution Remediation Act (the SGWPRA), an inspection should be conducted to confirm whether there is any pollution before the land or any buildings located thereon can be transferred. If any soil or groundwater pollution is found, remedial actions must be taken, and any party suffering damage from the pollution may seek compensation from the polluter and the owner. A gross violation of the SGWPRA carries criminal liabilities. As pollution not only has an adverse impact on the value of the property but also carries legal consequences, the results of due diligence on soil or groundwater pollution usually have a significant role in foreign investors' decisions on whether to purchase a specific piece of real property.

iii Tax

In addition to the transfer taxes and special tax explained above, a land or building owner must pay the land value tax or the house tax, as the case may be. Land value tax is payable on an annual basis to the city or county; it ranges roughly from 1 per cent to 5.5 per cent of the difference between the starting cumulative value and the current assessed and publicly announced land value. House tax is an annual tax assessed on all buildings; it ranges from 1.2 per cent to 5 per cent of the current assessed value of buildings, depending on their use.

iv Finance and security

Commercial properties include multi-family apartments, office buildings, retail space, hotels and resorts, warehouses and other commercial properties. For most commercial property transactions, foreign investors get financing from commercial lenders such as banks or other financial institutions; however, due to the higher risks associated with commercial properties, the loan-to-value ratios offered by commercial lenders in Taiwan are usually between 50 per cent and 70 per cent.

The most common form of security in Taiwan is a mortgage. A mortgage over real property, including land and buildings, must be registered with the land office to be valid. The foreclosure of a mortgage generally takes around three months to complete.

VI LEASES OF BUSINESS PREMISES

The Civil Code and the Land Act are the two major laws that regulate leases in Taiwan. While the Civil Code contains provisions on lease agreements in general, the Land Act contains provisions on, *inter alia*, administrative matters such as cadastration, land registration, land use, land tax and land expropriation; lease of houses, building sites and farmland; and tenants' rights, such as restrictions on the termination of a lease by landlords, and maximum rental rates for residential housing. According to judicial decisions, tenants of commercial buildings are not entitled to all the protection afforded under the Land Act to tenants of residential buildings (such as apartments).

In Taiwan, the market for leasing commercial and residential properties is fairly active. Lease terms, except for the lease for the construction of buildings, cannot be longer than 20 years[11] and are generally for five years or longer for commercial properties, and one year or longer for residential properties. In addition, any real property lease for more than one year must be in writing,[12] otherwise, the lease will be deemed a lease for an indefinite term, which both parties may terminate at will by prior notice. If, after the expiry of a lease, the tenant continues to occupy the leased premises or to generate profit therefrom, and the landlord does not object, the lease will be deemed to be for an indefinite term.[13]

If the tenant is in possession of the leased premises when the landlord transfers the leased premises to a third party, the lease will bind the third-party transferee. This rule does not, however, apply to leases of over five years or of indefinite duration unless the leases concerned have been notarised.[14]

In Taiwan, most landlords require a security deposit equivalent to two months' rent or more. For residential properties, the maximum security deposit that landlords may demand by law is equivalent to two months' rent.[15]

Should the parties to an indefinite-term lease have a dispute over the rent because of a change in the value of the leased premises, either party may ask the court to adjust

11 Article 449 of the Civil Code.

12 Article 422 of the Civil Code.

13 Article 451 of the Civil Code.

14 Article 425 of the Civil Code.

15 Article 99 of the Land Act.

the rent,[16] unless the lease agreement already provides a rent adjustment mechanism.[17] For commercial properties, it is common for the landlord and the tenant to stipulate in their lease agreement a provision on the adjustment of rent every two to three years based on a fixed percentage or on a floating index to be announced by the government. It is also common for the operator of a department store or a shopping centre to require that the shop tenant pay the rent consisting of a fixed monthly rent or a turnover monthly rent, or both.

The Civil Code requires a tenant to return the leased premises to the landlord upon the expiry of a lease without indicating whether the returned leased premises should be restored to its original state; however, tenants that remove the fixtures attached by them to the leased premises should restore the leased premises to its original state.[18] In Taiwan, most lease agreements contain a provision on the return of the leased property, which is negotiable. The tenant would usually be required to return the leased premises either in its original state except for normal wear and tear; or on an 'as is' basis.

For a master lease, landlords generally procure fire insurance to cover the replacement cost of the entire leased building. Master tenants are usually required to purchase all-risk construction and installation insurance to cover the full cost of construction with limits customary for such activities on the leased premises; general commercial liability insurance against liabilities such as bodily injury, death and property damage; and fire insurance covering the full replacement cost of the leasehold improvements and their personal property on the leased premises. Sub-tenants are commonly required to purchase similar types of insurance for their leased premises.

In practice, most master tenants usually choose to sign a memorandum of understanding (MOU) or letter of intent (LOI) with their landlords to lay out the major lease terms and conditions (although neither the MOU nor the LOI may necessarily be binding) even if a definitive lease agreement is signed later.

VII DEVELOPMENTS IN PRACTICE

In the residential property market, Taiwan has one of the highest housing ownership rates in the world, while social housing accounts for less than 10 per cent of households. At present, housing ownership – especially in urban areas of Taipei – is increasing. As housing supply has fallen short of demand over the years, residential property prices have been rising since the SARS epidemic ended in 2003.

Compared with other Asian countries, Taiwan has had one of the most vibrant commercial property markets over the years, with insurance companies, developers and foreign equity funds being the major market players. As commercial property prices in Taiwan keep soaring, many investors are keen to tap the opportunities in this sector despite the low gross rental yields. The most direct way for the insurance companies or

16 Article 442 of the Civil Code.

17 Supreme Court Judgments No. 86 *Tai-Shang-Zi-Di-1613* (1997) and No. 88 *Tai-Shang-Zi-Di-287* (1999).

18 Paragraph 2, Article 431 of the Civil Code.

foreign equity funds to invest in the commercial property market would be acquiring commercial property (with financing from local syndicated banks), receiving stable rental yields by succeeding the existing lease (if any), and realising considerable capital gains by selling the property within a certain number of years of acquisition.

As insurance companies are active participants in Taiwan's commercial real property market, to enhance the supervisory controls over insurance companies' real property investment and internal regulation for the insurance industry, the Financial Supervisory Commission amended the Criteria and Principles for Determining Instant Utilisation and Profitability from Real Property Investments of Insurance Companies, effective on 19 November 2012. While the amended criteria help maintain insurance companies' operational stability, the criteria to be met by insurance companies to be able to participate in real property investment have become more rigid.

VIII OUTLOOK AND CONCLUSIONS

According to recent government research, Taiwan's housing prices hit a record high in the second quarter of 2011 and continued to climb in 2012. To curb rapidly soaring housing prices, address the problems arising from uneven supply and demand in the market, and protect the public's right to affordable housing, on 13 December 2011 the Legislative Yuan enacted the Housing Act, and amended the Land Expropriation Act, the Real Estate Brokering Management Act, the Land Administration Agent Act and the Equalisation of Land Rights Act.

Under the new regulations, central and local governments have to build public houses, 10 per cent of which must be rented to disadvantaged groups. Moreover, land must be expropriated with compensation calculated at the market value, rather than the current assessed land value. In addition, to increase transparency in the real property market, since 1 August 2012 it has become a compulsory requirement for the purchaser, the land administration agent or the real property broker of a given transaction to register the actual transaction prices within 30 days of the completion of the title transfer so that the public may have access to such information. With public access to actual transaction prices of real property, conveyancing taxes (mainly the LVIT and the deed tax, which have long been underestimated because of the lower government assessed value) are expected, in the near future, to be levied according to actual transaction prices.

As affordable housing is at the top of its agenda, the government will in all likelihood introduce more measures to regulate the residential property market, which as a result would remain a highly restricted sector for foreign investment. On the other hand, further regulatory relaxation is expected in both the commercial property and the infrastructure sectors because of the economic momentum the country enjoys and the low level of potential social problems. In fact, the government has welcomed foreign investment in commercial properties and infrastructure projects in recent years.

In terms of possible political risks, the Taiwan political environment should remain stable in coming years in view of the efforts of the government to maintain peaceful ties with mainland China and to spur economic growth.

The risk of a property bubble burst is fairly low, because the government has pledged to control price hikes in the residential property sector, and property prices in

Taiwan are moderate compared with those in other major Asian countries. Despite the recent global economic downturn caused by the sovereign debt crisis in Europe and the fiscal crash in the US, it is generally believed that commercial property demand, especially in the urban areas of Taiwan, will remain strong because of the influx of foreign capital, low lending interest rates, moderate property prices and a higher demand driven by increasing numbers of tourists from mainland China. All these can create a more vibrant and dynamic real property market in the next few years.

Chapter 37

TURKEY

Barlas Balcıoğlu and Ali Can Gören[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

Under the Turkish Civil Code,[2] lands, independent and permanent rights (such as the right of construction) perfected into the land registry records, and independent units registered under the Condominium Law[3] are considered as real estate.

Ownership of real estate can be in the form of simple (i.e., full) ownership, co-ownership or joint ownership. Simple ownership is the most common type of ownership, followed by co-ownership and joint ownership. Co-ownership and joint ownership differ on the disposal of the shares owned: a co-owner may not dispose of its shares without the consent of the other co-owners, whereas each joint owner can freely dispose of its share without the consent of the other joint owners.

The following ownership rights exist under Turkish law.

a Freehold gives full ownership (*in rem*).

b Usufruct right gives a real right to use the property, except the ownership (*in rem*).

c Occupancy right gives a real right to reside in the property (*in rem*).

d Easement right gives a real right to construct a building without possessing it (*in rem*).

f Concession right gives a contractual right on the property (*in personam*).

g Leasehold gives a contractual right to lease the property (*in personam*).

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2 Turkish Civil Code, Code No. 4721.

3 Condominium Law, Law No. 634.

h There are other rights such as transit right, which gives a right to pass from one place to another, or resource right, which gives a right to use, for example, the water supply in the adjacent property. Parties can further create rights *in rem*, but they are limited to those provided under the relevant laws (*numerus clausus*).

Freehold is the most extensive right over real estate under Turkish law, granting the owner the right to use freely (*usus*), enjoy the benefits (*fructus*) and dispose of it (*abusus*) within the limits of the law. Freehold also allows the owner of real estate to dispose of it at will, request it back from anyone who wrongfully retains it or to take measures to prevent any unlawful interference with it.

The ownership right is protected by the Turkish Constitution of 1982 as a fundamental right subject to limitation only for public interest. Certain restrictions apply to foreign individuals, foreign legal entities or their Turkish subsidiaries concerning the purchase of real estate.

ii System of registration

The Turkish land registry system has recently become an electronically centralised system; nevertheless, physical, individual records are still kept in each administrative district under the control of a land registry directorate. There are approximately 1,000 land registry directorates in Turkey. Each directorate is under the supervision of one of seven regional land registry group directorates, which in turn are under the control of the national General Directorate of Land Registry and Cadastre.

Land records are registered in an electronic database, the Turkish Land Registry and Cadastre Information System (TAKBIS), and in title books held by district land registry directorates. Each plot is registered on an independent page of the title book. In the event that a plot covers an area within the boundaries of more than one district, it is registered in each relevant district; however, registration requests are directed to the land registry where the largest part of the real estate is located.

Transfer of title to real estate is valid upon signing and registration of an official deed before the relevant land registry directorate. Failing such registration, the purported owner will generally not be recognised as the legal title holder and will be unable to enforce ownership rights.

Exceptions to this general principle (i.e., cases where enforceable ownership rights may arise notwithstanding registration) include transfers by inheritance, court order, adverse possession, compulsory execution and expropriation. Even in such cases, no disposal of land is permitted unless the previous transfer has been registered with the land registry records.

In addition to the land register's constitutive feature, it is a public register; any person registered as the holder of a particular right over a property will be protected against *bona fide* right acquisition claims of third persons. Therefore, a third party may rely on the contents of the land register as any establishment or transfer of a right made by a person registered in the land register, as the right holder will be upheld.

iii Choice of law

The choice of law materially depends on the structuring of the investment. A share deal (i.e., transfer of shares of an entity owning the real estate) or an asset deal (i.e., transfer of ownership of the real estate) are the available structures for a transaction involving real estate.

It is possible to choose foreign law as the governing law of the legal documentation of a share deal. However, the governing law for an asset deal will be Turkish law, as the transfer of ownership requires the signing and registration of an official deed before the relevant land registry directorate in Turkey.

II OVERVIEW OF REAL ESTATE ACTIVITY

As a result of the consistent growth in its economy over the past 10 years, during which it has received a significant amount of direct foreign investment, Turkey is becoming increasingly integrated into the globalised world. Although Turkey's growth rate of 8.8 per cent in 2011 dropped to 2.2 per cent in 2012, this decrease is mainly attributable to the global economic slowdown. Regarding real estate activity in particular, according to the Turkish Statistics Institute, in the first nine months of 2013:

a the aggregate surface area of buildings granted a construction permit increased by 9.3 per cent, the number of such buildings increased by 13.4 per cent and their value increased by 13.8 per cent; and

b the aggregate surface area of buildings granted an occupancy permit increased by 29.1 per cent, the number of such buildings increased by 24.4 per cent and their value increased by 36.8 per cent.

Compared with other sectors, the real estate investment market has always been more local, mostly driven by Turkish investors' residential, office or mixed-use projects. International investors have, however, shown significant interest in the Turkish retail market in the past decade. Most direct foreign investment has focused on the development or acquisition of shopping centres, or on mixed-use projects. Well-known developers such as Aerium, Amstar, Corio and Multi Corporation, and major private equity houses including Blackstone, GIC, Canada Pension Plan Investment Board and the Bosphorus Real Estate Fund, established by Bank of America Merrill Lynch, have been very active in the retail market. They currently own a significant portion of shopping centres in Turkey.

The interest shown in the Turkish market by international hotel chains has also driven the growth in Turkey's real estate investment market. Marriott, W Hotels, Crowne Hotels, Sheraton, Hyatt Regency, Hilton, Mövenpick Hotels and Resorts, Novotel, Wyndham and Ibis have all opened new hotels in the past 10 years. Most have opened their first Turkish hotels in Istanbul, recognising the city as a highly respected metropolitan centre.

This investment has positively affected the construction market: the opportunity presented by the increase in demand all over Turkey has seen many well-known construction companies developing several hotel projects. Istanbul, with 73 international chain hotels in operation and, as of November 2013, 32 hotels scheduled to be open before 2015, is currently one of the leading cities for new tourism investment.

The office market has also been active in 2013, with many investors developing new office projects or mixed-use projects including office spaces. Nonetheless, these projects have not reduced the need for institutional quality, grade A office spaces in Turkey. As always, Istanbul leads the race for the most office space, followed by Ankara and Izmir. Being a metropolitan city with no actual centre, Istanbul has developed more than one commercial centre to accommodate demand for offices.

III FOREIGN INVESTMENT

To enhance foreign investment and secure a more confident investment climate for foreign investors, the Parliament enacted the Foreign Direct Investment Law (the FDI Law)[4] in 2003. The FDI Law has introduced major changes in the foreign investment climate by eliminating legal restrictions, harmonising the foreign investment legal scheme with international standards and creating a liberal system to attract foreign investors.

Foreign investors are entitled to establish a company with 100 per cent foreign capital or to acquire all of the shares of an existing Turkish company. There is no restriction on the percentage of foreign ownership or on the participation of foreigners in the management of a company, except in some specific sectors such as radio, television, aviation and fisheries between Turkish ports.

Restrictions or limitations are still in place, however, concerning the acquisition of real estate by foreign entities or their Turkish subsidiaries. Foreign legal entities are only allowed to acquire real estate for petroleum exploration and extraction, and investment in tourism and industrial regions. Such restrictions also apply to other rights *in rem* (i.e., easements and servitudes), except for mortgages created in favour of foreign creditors.

There is no direct limitation on the acquisition of real estate by Turkish companies with foreign capital. However, such acquisitions are subject to approval by the relevant governorship where the real estate is located if 50 per cent or more of the shares of the acquiring company are owned by a foreign entity or individual, or such entity or individual has privileges to appoint and dismiss the majority of the acquiring company's directors. In practice, the approval is easily granted, except for lands located in military, strategic or special security zones.

IV STRUCTURING THE INVESTMENT

As in other jurisdictions, a real estate investment in Turkey can be structured as a share deal (i.e., acquisition of shares of an existing company owning real estate) or as an asset deal (i.e., acquisition of the real estate). In an asset deal, a foreign investor must establish a local special purpose vehicle (SPV), as Turkish law does not allow foreign entities to acquire real estate directly (with the few exceptions previously mentioned). It is tax-efficient practice to use a Luxembourg or Dutch entity as either the purchaser of the shares of the existing Turkish company or the shareholder of the SPV acquiring the real estate.

4 Foreign Direct Investment Law, Law No. 4875.

The SPV can be established as a joint-stock company (JSC) or a limited liability company (LLC). Each has its advantages and disadvantages, but – unless a real estate investment trust (REIT) (see Section IV, *infra*) is used – both entities are easy to incorporate and maintain. Both can be established with a sole shareholder, and can be managed by a sole board member (for a JSC) or a sole manager (for an LLC). The major difference between a JSC and an LLC is the shareholders' liability. If the SPV cannot fulfil its payment obligations in respect of the governmental authorities, shareholders of an LLC are directly liable for amounts owed for taxes, duties and charges in proportion to their shares, not to the investment amount.

In return, an LLC offers more flexibility to tailor its articles of association: purchase or repurchase of shares, put and call options over capital shares, limitation of share transfers, right of exit from the company, additional-payment and secondary performance obligations and non-competition clauses for the shareholders may be set forth in the articles of association. They are, therefore, more suitable for joint ventures.

The minimum capital requirements for SPVs are low (50,000 Turkish lira for JSCs and 10,000 Turkish lira for LLCs) compared with the average Turkish real estate investment, but to avoid thin capital issues due to the value of the invested real estate, SPVs are generally incorporated with the minimum share capital; they do increase their share capital after the acquisition.

An asset deal is far more costly than a share deal in terms of associated costs. In an asset deal, the land registry charges are paid at the rate of 4 per cent of the purchase price, generally split equally by the parties. Additionally, VAT is payable at the rate of 18 per cent of the purchase price, unless there is a VAT exemption (see Section V.iii, *infra*).

In a share deal, the share purchase agreement is subject to stamp duty at the rate of 0.948 per cent of the highest amount in the agreement. The highest amount can be the purchase price or a penalty associated with the specific performance of an obligation under the agreement or otherwise. The general rule is that if the amount is quantifiable, it is subject to stamp duty. However, the final determination on whether stamp duty will be triggered in a certain agreement must be made by a tax adviser.

One of the major advantages of a share deal is the absence of a form requirement for the share purchase agreement (except the transfer of shares of an LLC, which requires a notarised share transfer deed), whereas an asset deal is subject to certain mandatory formalities. Therefore, before the entry into force of the New Turkish Commercial Code (the New TCC),[5] most real estate transactions were concluded as share deals to avoid lengthy procedures and associated high costs; however, this is set to change with the New TCC.

Share deal financing has been scarce in Turkey since the New TCC came into force, as it restricts leveraged buyouts at the target company level in which the asset is used as collateral to purchase the shares of the existing company (i.e., restriction on financial assistance). Under the repealed Turkish Commercial Code,[6] the common financing model was to push down acquisition debt to the target company by merging the purchasing entity into the target company, allowing the investors to use the target

5 New Turkish Commercial Code, Code No. 6102.

6 Repealed Turkish Commercial Code, Code No. 6762 previously in force since 1956.

company's funds to finance the investment. Alternatively, the target company's assets would serve as collateral for the financing parties to secure the acquisition debt borrowed by the purchasing entity.

The New TCC explicitly prohibits the target company from advancing funds, making loans available or providing security with a view to the acquisition of its shares by a third party. At present, therefore, foreign investors conclude asset deals more than share deals if bank financing is involved, despite the high associated costs.

Another option, the REIT structure, provides tax advantages for foreign investors in Turkish real estate. REITs, available since the late 90s under the supervision of the Capital Markets Board (the CMB), are well established in Turkey. Currently, 29 REITs are licensed by the CMB, and a further three in receipt of CMB licences but not yet established.

REITs offer major tax advantages (no corporate tax on income, etc.) when they purchase or sell real estate or distribute dividends to their shareholders; their major drawback, however, is the requirement to publicly offer shares of the REIT corresponding to at least 25 per cent of its share capital at the Istanbul Stock Exchange.

V REAL ESTATE OWNERSHIP

i Planning

Under the Zoning Law, land can only be used for the purpose specified in the relevant zoning plan. Plans are generally grouped as environmental order and zoning plans. The zoning plans are further divided into master plans and implementation plans.

Zoning plans are based on environmental order plans. In practice, environmental order plans are prepared in the 1/100,000 scale.

Master zoning plans may be prepared by using scales of 1/2,000, 1/5,000, 1/10,000 or 1/25,000. In practice, master zoning plans are prepared in 1/5,000 and 1/25,000 scales. These are based on environmental order plans, if available, and focus on a specific area where development can be carried out, the types of principal areas (such as industrial or commercial areas), and the density of population and construction. In master zoning plans, information regarding land development should be indicated in reasonable detail.

Implementation plans, in the 1/1,000 scale, show in detail the organisation of land and roads, and set out the methodology for achieving planned land development. The implementation plans also include cadastral details, if available.

Building and occupancy licences are issued in conformity with the zoning plans available for the relevant land.

ii Environment

The Environmental Law,[7] the principal legislation on environmental matters, prohibits the release, storage, transport, transfer and other similar actions of any and all discharges, debris and residue, directly or indirectly, in the environment in a polluting manner.

7 Environmental Law, Law No. 2872.

The Environmental Law does not refer to an owner or occupant of a land, but instead establishes no-fault liability for the polluter by the mere existence of pollution. Therefore, if the polluter is someone other than the property owner (e.g., a lessee), then the property owner has no liability in connection with the pollution. The 'polluter pays' doctrine is embodied in the Environmental Law. Accordingly, the polluter is liable for expenses related to the prevention, limitation or remediation of the pollution.

iii Tax

Fees for land register transactions are listed in the Law on Duties.[8] These fees are based on the taxable value of the real estate. The taxable value is at least the value stated in the real estate value statement obtained from the relevant municipality. Fees are payable in advance. Additional notary costs may apply. Both the purchaser and the seller are subject to these costs.

As of November 2013, the land registry fees are as follows:

a sale and transfer: (for the seller) 2 per cent of the contract price;
b transfer: (for the purchaser) 2 per cent of the contract price; and
c other land registry fees: approximately 175 Turkish lira.

If the seller or the purchaser is a legal entity, VAT at a rate of 18 per cent is paid by the purchaser in addition to the charges or duties shown; however, a VAT exemption may apply for:

a the sale of real property by individuals who are not estate agents;
b the delivery of offices and factories that are built in organised industrial zones or on small industrial sites;
c the sale of immoveable property by the state; or
d the sale of real property by a legal entity, provided that the property is owned by the seller for a minimum of two years.

iv Finance and security

Mortgage is the most common real estate collateral. There are two types of mortgage under Turkish law: a principal amount mortgage and a maximum amount mortgage.

A principal amount mortgage provides security for a principal amount, and covers the principal debt, default interest and interests that have accrued during the three years preceding the initiation of the execution proceedings, and enforcement costs.

A maximum amount mortgage provides security for claims from, or claims expected to arise from, a certain contractual relationship between the lender and the debtor up to a maximum limit set out in the mortgage agreement.

A principal amount mortgage provides a strong position in enforcement proceedings as it contains an unconditional acknowledgment of debt made by the debtor. The mortgagee may initiate the debt collection proceeding with an execution order, against which the mortgagor may object on a limited number of grounds. However,

8 Law on Duties, Law No. 492.

a maximum amount mortgage holder may initiate enforcement proceedings with a payment order, against which the debtor may object even to the merits of the claim.

VI LEASES OF BUSINESS PREMISES

Leases were, until 1 July 2012, governed by the Lease Law[9] and the Old Code of Obligations;[10] these have been replaced by the New Code of Obligations (the New TCO).[11] Nevertheless, lawmakers have decided to postpone until 1 July 2020 the application of some provisions under the New TCO regarding leases of commercial premises. These provisions might have adversely affected the commercial leasing situation in Turkey had they entered into force; they included, *inter alia*, a restriction on rent increase, a limitation on the grounds for termination by the landlord and a limitation on the security to be provided by tenants.

i Form of lease contracts

Under Turkish law, there is no form requirement for lease contracts regarding commercial or residential property. However, lease contracts for commercial premises customarily take written form.

ii Term of lease contracts

Lease contracts can be classified as definite-term and indefinite-term lease agreements. Definite-term lease contracts are automatically extended for one year unless the tenant terminates the lease agreement with a written notice 15 days before the end of the term. In practice, the lease term for residential property is usually one year, whereas for commercial property, the minimum term is generally five years.

iii Denomination in a foreign currency and prohibition of rent increase

Turkish law allows the denomination of rents in a foreign currency. However, the postponed provision of the New TCO provides that rent denominated in a foreign currency may not be subject to increase for an initial term of five years.

In practice, most leases for commercial premises have rents denominated in a foreign currency, subject to increase on the basis of an agreed indexation. These agreed rent increase and indexation clauses will be enforceable until 30 June 2020, as the implementation of the restriction has been postponed. After the postponement period rents will probably be denominated in Turkish lira, because the permitted annual increase in rent will be limited to no more than the annual average of the Turkish Statistical Institute's producer price index.

Regardless of whether the rent is denominated in Turkish lira or a foreign currency, upon the expiry of each five-year period, either party may request from a competent

9 Lease Law, Law No. 6570.

10 Old Turkish Code of Obligations, Code No. 818.

11 New Turkish Code of Obligations, Code No. 6098.

court a rent determination based on applicable market prices, the condition of the leased premises and other conditions affecting the rent.

iv Termination of lease contracts

In principle, there are limited statutory grounds entitling landlords to terminate lease contracts; other than this, landlords are unable to terminate lease contracts because of expiry of the term, except in the case of the termination of a definite-term lease contract upon the expiry of 10 years of renewals by serving the tenant with a three-month prior written notice. However, this limitation is not applicable to commercial leases until 1 July 2020. In the interim, we believe that, on the principle of freedom of contract, termination provisions (if there are any) should be enforceable in lease contracts. Nevertheless, there are no precedents, and the stance of the Court of Appeals is unclear. In the past, the Court of Appeals has adopted a pro-tenant approach to unclear areas of law; therefore, the provision of termination rights for the landlord in some lease contracts may not be enforceable.

In cases of early termination of a lease contract by a tenant, the New TCO states that a landlord is only entitled to fair compensation, which may not exceed the amount of rent due until the end of the term. The established court practice is to determine the amount of compensation in the range of three to six months' rent, depending on the amount due until the end of the term.

v Security

In general, landlords require tenants to provide security in cash or in the form of a bank letter of guarantee before they lease the property. For commercial properties, the amount of the security generally equals two to three months' rent. However, the exact amount is determined by mutual agreement. Nevertheless, the New TCO has limited the amount of the security to three months' rent. However, this limitation does not apply for leases of commercial premises until 1 July 2020.

VII DEVELOPMENTS IN PRACTICE

i Draft Law on the Regulation of Retail Commerce

In wake of the recent public criticism directed at the unchecked development of shopping malls and the various pre-existing issues within the retail market, the Parliament has decided to initiate works on a Draft Law on the Regulation of Retail Commerce. As mentioned under Section II, *supra*, the retail sector (shopping centres in particular) plays an important role for foreign investors in the Turkish real estate market. Accordingly, the Draft Law on the Regulation of Retail Commerce has the potential to play a critical role in foreign investors' future dealings in the Turkish market.

The Draft Law on the Regulation of Retail Commerce envisages, *inter alia*, the formation of strategic commercial plan commissions', which will in turn prepare a strategic commercial plan for each city. Currently, the strategic commercial plan commissions are planned to consist exclusively of members of the administration and certain professional associations. The strategic commercial plans will determine which retail businesses may be established and the amount of retail businesses that may be established in any given location, in an effort to maximise efficiency. Accordingly, retail businesses (including shopping centres) are required to obtain an official authorisation from the relevant metropolitan municipality to establish and carry out their operations.

Pursuant to another provision of the Draft Law on the Regulation of Retail Commerce, shopping centres will be required to reserve a minimum of 5 per cent of their leasable areas for artisans and 1 per cent of the same for artisans of vanishing arts. Under Turkish law, artisans are smaller enterprises that do not qualify as merchants; however, to date there is no legal definition as to which arts will qualify as vanishing arts. Furthermore, shopping centres with a sale area of between 2,500 and 5,000 square metres are required to reserve an area of 100 square metres; those having a sale area between 5,001 and 1,0000 square metres are required to reserve an area of 150 square metres; and those having a sale area of over 10,000 square metres are required to reserve an area of 200 square metres for socio-cultural activities.

Finally, potential foreign investors should be aware that instances of non-compliance with the provisions of the Draft Law on the Regulation of Retail Commerce are envisaged to be punishable by significant administrative fines.

ii Planned Areas Standardised Zoning Regulation

On 8 September 2013, the Regulation Amending the Planned Areas Standardised Zoning Regulation (the Amendment Regulation) entered into force, whereby the majority of the provisions of the Planned Areas Standardised Zoning Regulation were amended. The Planned Areas Standardised Zoning Regulation is a set of standard fallback provisions in relation to matters not covered by the zoning plans or the zoning regulations pertaining to a real estate.

By virtue of Decree No. 4895 dated 29 May 2013, the Ministry of Environment and Urban Development has declared that all zoning regulations have been abrogated. Municipalities were further instructed to draft new zoning regulations that are compliant with the Planned Areas Standardised Zoning Regulation as amended by the Amendment Regulation, and submit these to the Ministry of Environment and Urban Development within a period of one year as of 31 May 2013. Accordingly, potential investors should be advised that the provisions of the Planned Areas Standardised Zoning Regulation shall apply to any construction permit applications made after 31 May 2013.

iii Remote Title Deed Transactions Regulation

On 30 April 2012, the Regulation on the Execution of Title Deed Transactions by Land Registries of Properties Located Outside their Jurisdictions (the Remote Title Deed Transactions Regulation) entered into force. Before the entry into force of the Remote Title Deed Transactions Regulation, the land registries did not have the authority to carry out title deed transactions (including property transfers) for real estate located outside their jurisdictions. Since the implementation of the Remote Title Deed Transactions Regulation, the parties of a title deed transaction may make an official application to a land registry of their choosing in order to carry out the transaction at the foregoing instead of the land registry where the real estate is located. Once the official application is deemed acceptable, the parties execute the title deed transaction before the land registry of their choosing, and the transaction is completed over TAKBIS.

iv Licensed cartography and cadastre bureaux

On 15 June 2013, the Regulation on Licensed Cartography and Cadastre Engineers and Bureaux entered into force. Licensed cartography and cadastre bureaux are private enterprises authorised by the administration to carry out official cadastral works. Licensed cartography and cadastre bureaux previously existed in the Turkish legal system, but the old Regulation on Licensed Cartography and Cadastre Engineers and Bureaux was abrogated and they were shut down. Reinstatement of the licensed cartography and cadastre bureaux is an important development, since the administration is usually slow to carry out cadastral works due to its heavy workload.

VIII OUTLOOK AND CONCLUSIONS

Throughout 2013, Turkey managed a steady growth and maintains its appeal for international investors, despite the global economic slowdown. The stable inflow of foreign investment, coupled with important infrastructure projects such as the international airport, the third bridge to be constructed over the Bosphorus and numerous urban transformation projects, will fuel the real estate market in the future.

Chapter 38

UKRAINE

Vladislav Kysil[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

Titles to real estate (buildings, facilities and other immoveable properties located on land plots) in Ukraine relevant to private persons and entities include ownership (freehold title), *in rem* rights (leasehold, mortgage) and rights *in re aliena* (servitudes, *superficies*, *emphyteusis*).

In general, the titles to real property stipulated by Ukrainian civil law are similar to those of the civil law countries of continental Europe.

Titles to land are subject to a special regulatory regime established by land law.[2] Land plots are subject to regulation by the Civil Code and the Land Code. Under the Land Code, land can be owned, used permanently or leased. The land law also recognises the mortgage of land plots and rights *in re aliena*: servitudes, *superficies* and *emphyteusis*. Ukrainian citizens and companies are permitted to own most types of land; the Land Code, however, does not allow foreigners and foreign legal entities to own agricultural land.

The Land Code specifies that permanent use may be granted only to state-owned or communally (municipality) owned companies. Private companies generally may not obtain land on a permanent-use basis; they must lease the land on a commercial basis or obtain ownership title to the land.

1 Vladislav Kysil is a partner at KPD Consulting Law Firm.

2 The Land Code of Ukraine (the Land Code) and legislative acts and by-laws comprising the regulatory basis of Ukrainian land law.

ii System of registration

As of 1 January 2013, the system of land registration comprises two elements:

a registration of land plots in the state land cadastre by the land authorities[3] (in practice, the allocation of a unique cadastral number to each land plot and collection of data on boundaries, designated use, zoning restrictions and other land-plot characteristics in the electronic database of the public land cadastre system) that is attributable to the land plots only; and

b registration of title to the real property (including land plots, buildings, facilities and other immoveable properties located on the land plots) in the state title registry (e.g., recording information about the registered title holder of the property).

The registration of title to a real property is absolutely necessary for any transaction related to the property; an agreement executed in respect of real property that was not registered before entering into such transaction shall be considered null and void.

Moreover, the validity and effectiveness of any title to real property created by entering into an agreement is directly dependent on subsequent registration of title in the state title registry. According to Article 3 of the Title Registration Law,[4] any title to real property (e.g., ownership, mortgage or lease for a term over three years) is valid as from its registration in the state title registry. Title will not transfer to the party of transaction if it has not been registered; should the buyer fail to register the title under the sale and purchase agreement, the buyer will not become the owner of the property until the title is registered.

iii Choice of law

The concept of conflict of laws is not sufficiently developed in Ukrainian law to permit a choice of law governing real estate transactions. Mandatory provisions of the Law of Ukraine on Private International Law stipulate that matters of occurrence, transfer of ownership title and other rights to real property registered in Ukraine are exclusively governed by Ukrainian law, and it is the required choice of law for transactions involving real property located in Ukraine.

II OVERVIEW OF REAL ESTATE ACTIVITY

Ukraine's GDP decreased by 1.5 per cent in Q3 2013, compared with the same period in 2012, and it is 0.4 per cent less than in Q2 2013. The key drivers of this negative trend were a shrinking of industrial production by 5.2 per cent year on year (yoy) and a decrease in external demand of 8.1 per cent yoy during the period from January to August 2013. According to the IMF, GDP growth in Ukraine is estimated at 0.4 per cent

3 According to Article 6 of the Law of Ukraine on Public Land Cadastre of 7 July 2011 No. 3613-VI, the land authorities are the Public Land Agency, its local subsidiaries and the public cadastre registrars – public officers primarily and directly responsible for registration.

4 The Law of Ukraine on Public Registration of Titles to Immoveable Property and Encumbrances Thereof of 1 July 2004 No. 1952-IV.

for 2013. The World Bank estimate puts Ukrainian GDP growth in 2013 at 1 per cent as the best-case scenario.

Despite the general economic downturn, the consumer sector continues to grow, albeit at a reduced pace. In the period from January to September 2013, retail turnover growth was at 9.8 per cent, which is significantly lower than it was in the same period in 2012 (16 per cent). Nonetheless, market analysts note that since Ukrainians spend over 85 per cent of their total income on goods and services, the consumer sector remained sustainable in 2013.

Commercial real estate development continues to suffer from the effects of the credit crunch and the slowdown of the national economy. However, two segments of the sector – retail and residential construction – showed comparatively good results in 2012 and 2013.

According to DTZ, around 1.2 million square metres (gross leasable area) of new modern retail space is currently in the active stages of planning or construction in Kiev. If these properties have been commissioned in accordance with the announced plans, by 2016 retail stock in the Ukrainian capital may double, which will not only lead to strengthening competition in the sector, but also may create more opportunities for occupiers.[5]

Due to the slowdown in business activity and an essential increase of office schemes supply, the common opinion is that the market in 2013 was a tenants' market. DTZ analysts expect that market-wide rents will be subject to some further downward pressure in the short term. In the longer term, occupier demand dynamics should be enough to sustain the current level of office rents in Kiev.

According to Jones Lang LaSalle, prime yields remain unchanged at 11.75 per cent for offices and 11.5 per cent for shopping malls.[6]

Despite some yield compression, prime property yields in Kiev and a few other major Ukrainian cities are at high levels compared with those in other eastern and central European capitals.

III FOREIGN INVESTMENT

The Land Code of Ukraine directly prohibits foreigners, foreign companies and other foreign legal entities from owning agricultural land in Ukraine. Moreover, overseas investors (i.e., foreign legal entities or individuals) may only acquire ownership title to a non-agricultural land plot outside a city if the investor simultaneously acquires title to buildings located on the plot; the prospect of greenfield development outside cities is, therefore, limited for foreign investors.

5 DTZ: Property Times Ukraine Q2 'On the threshold of change' (www.dtz.com, under DTZ research).

6 www.joneslanglasalle.ua/ResearchLevel1/Commercial_Real_Estate_Market_Q3_2013_JLL_eng.pdf.

These constraints notwithstanding, any foreign investment, including investment in acquisition of commercial real property, and divestment of the profit from it (e.g., rent), must follow currency control regulations.

The Ukrainian currency control system was established by State Decree on the System of Currency Regulation and Currency Control of 19 February 1993 No. 15-93 and the regulations of the National Bank of Ukraine (NBU).

For foreign currency transfers in which the contract value exceeds €100,000, NBU Regulation No. 597 of 30 December 2003 requires the payer (e.g., the tenant) to provide its bank with a price evaluation certificate issued by the state price monitoring agency, DerzhZovnishInform (the DZI). The DZI certifies that the contract prices are in line with current market prices. If the contract prices do not correspond with the current market situation (i.e., essentially, the contract rent exceeds the rent for similar premises), the DZI will not issue the price evaluation certificate. The transfer of foreign currency under contracts exceeding €100,000 without the DZI certificate is strictly prohibited.

IV STRUCTURING THE INVESTMENT

The following investment structures are commonly used for real estate projects in Ukraine.

i Joint activity agreement

Ukrainian law provides for two types of joint activity agreement (JAA): a simple partnership with a combination of participants' funds or assets, or a joint venture without a combination of contributions.

In a simple partnership, assets contributed by JAA parties, along with goods produced and profits obtained as a result of joint activity, are treated as joint shared property of participants, unless otherwise established by the simple partnership agreement or by law. In large part, Ukrainian law allows JAA participants to agree freely on various issues, including, *inter alia*, the treatment of the status of joint shared property and the percentage interests held by the participants in the JAA.

While there is regulatory guidance available for simple partnerships, in this respect there is insufficient provision under Ukrainian law regarding the joint venture organised without combined funds or assets.

One of the critical aspects of JAA operations is day-to-day management. JAA operational management issues are to be set out and agreed upon in a joint activity agreement. Ukrainian law provides for use of a separate joint activity bank account through which all payments in connection with JAA operations must be made. The bank account, to be opened and managed by the JAA operator, may be in a foreign currency or in Ukrainian hryvnas.

ii Concession agreements

Public-private partnerships in Ukraine are governed by the Public-Private Partnership Law. The concession agreement is one of the principal types of public-private vehicles in Ukraine.

The concession agreement stipulates that the concessionaire undertakes obligations to create (construct) or manage (operate) the concession property, assuming possible commercial risks. The build-operate-transfer principle is recognised by Ukrainian concession law.

As a general rule, concessionaires must be selected primarily by open tender. Concession law also provides that facilities specially built pursuant to the terms and conditions of a concession agreement may be granted into concession (i.e., the concession law allows the option of greenfield construction).

iii Companies of private law (limited liability company (LLC) or joint-stock company (JSC))

The Law of Ukraine on Commercial Companies dated 19 September 1991 and the Law of Ukraine on Joint-Stock Companies dated 17 September 2008 provide for the two most common vehicles for conducting commercial real estate business activities in Ukraine: the JSC and the LLC, both of which embody the concept of limited liability for investors.

JSC

A JSC is very similar in form and operation to a US corporation: it is a company with authorised capital divided into shares of equal nominal value. Shareholders in a JSC are only liable for the obligations of the entity to the extent of their capital contributions. There are two types of JSC: public and private. A public JSC is established through a public offering and subscription of shares, whereas the shares of a private JSC are distributed initially only among the founding shareholders. Shares issued by public and private JSCs must be registered with the State Commission for Securities and Stock Market of Ukraine (the Securities Commission). A minimum capitalisation of 1.28 million hryvnas is required to establish a JSC.

A JSC has four corporate bodies: the shareholders' meeting, the supervisory council (i.e., the board of directors), the management and the audit commission. The shareholders' meeting is the highest governing body and is responsible for policy decisions. The supervisory council's authority may be broad or narrow, as specified either in the charter of the JSC or through resolutions adopted at the shareholders' meetings.

A JSC must be registered with the Ukrainian registration authorities (Public Registrar of Companies) to acquire the status of a legal entity.

Some financial institutions require that SPVs involved in large real estate transactions and project financing are established in the form of a JSC as the pledge of JSC shares provides greater security for the lender than the pledge of participatory interests in an LLC.

LLC

The LLC is the most popular form of corporate entity suitable as a vehicle for real estate transactions in Ukraine.

The LLC is similar to both a US corporation and a US partnership. Like a corporation, it is a limited liability company in which the interest holders (participants) are liable only to the extent of their capitalisation. As in a partnership, ownership interests are shared in terms of contractual rights arising from constituting documents. An LLC can be created by one or more persons (including a single legal entity), but it cannot be founded by a legal entity that is also a single participant company. There is, however, no minimum capitalisation or mandatory requirements regarding payment of some share of authorised charter capital prior to the establishing of the company.

An LLC usually has three governing bodies: the general meeting of participants, the directorate (board of directors or single director) and a controlling body – the audit commission. An external audit is not mandatory for an LLC (except when required by any of the LLC's participants). A participant in an LLC may alienate its ownership interest, unless provided otherwise in the LLC's charter. The other participants of the LLC have the pre-emptive right to acquire the share, which the alienating participant should respect, unless provided otherwise in the charter of the LLC or agreed by the participants themselves.

LLCs have an essentially simpler registration process than JSCs (no issue of shares to be registered with the Securities Commission) and, compared with a JSC, they permit simpler procedures for the increase of capital, amendments to the charter and changes in management; this makes an LLC the preferred corporate form for real estate projects.

According to Article 63 of the Commercial Code of Ukraine, a wholly foreign-owned Ukrainian company is considered a foreign enterprise. The law is not clear whether the foreign enterprise shall be considered as the foreign legal entity of the Land Code. Moreover, the State Committee on Land Resources stated in its letter dated 17 May 2008 No. 14-17-11/4621 that foreign enterprises (wholly foreign-owned companies) are not allowed to acquire ownership title to a land plot, as this right is not stipulated by the strict construction of Article 82 of the Land Code. To avoid possible negative consequences, it is advisable that such foreign enterprises avoid acquiring the freehold to land.

V REAL ESTATE OWNERSHIP

i Planning

Ukrainian law classifies land plots under the categories of designated purpose and designated use. Designated use, cited regularly in construction and project documentation, is a narrower regulatory zoning classification than the general statutory zoning classification – designated purpose – used in the Land Code. Land plot title documents should specifically state a land plot's designated purpose so that it can be determined whether the plot is suitable for development.

Classifications for designated use do not entirely correspond to those for designated purpose under the Land Code, as the designated-use classifications refer to urban planning documentation (general city plans, detailed plans of territories, scheme of territory planning, etc.). It is important, therefore, to verify both the designated purpose (land zoning) and the designated use (construction zoning) to avoid misunderstandings regarding the Land Code zoning of a land plot when seeking construction permits.

Rezoning of designated purpose generally requires a municipal council decision; rezoning of designated use requires the amendment of the municipality's general construction plan, also by council decision.

ii Environment

Legislation on protection of land and for safeguarding the condition and fertility of agricultural land is quite developed in Ukraine. The State Agricultural Inspection agency may conduct land audits and investigations, and in cases of contamination of land may impose penalties on the guilty parties and file lawsuits for recovery of damages. Contamination of land, or causing considerable damage to land by removing fertile soil, may also lead to criminal liability; the amount of damage in this case shall exceed 56,000 hryvnas.

iii Tax

There are three principal transaction costs for the sale and purchase of real property in Ukraine:

a State pension duty, amounting to 1 per cent of the purchase price (excluding VAT), which shall be paid in national currency by the buyer before execution of the sale and purchase agreement. Documentary evidence of payment shall be provided to the notary that certifies the agreement. Sale and purchase of land is exempt from state pension duty.

b A notary fee, amounting to 1 per cent of the purchase price, which is typically borne by the seller since the buyer pays state pension duty. The parties may agree to share the cost.

c A title registration duty and fee, which is a relatively small amount, fixed for all properties regardless of the size of the transaction. The fee does not exceed 400 hryvnas for each title registration.

iv Finance and security

According to the Law of Ukraine on Mortgages (the Mortgage Law), the mortgage is a type of security with immoveable property, whereby the mortgagee shall have the right to satisfy its claims at the expense of the mortgaged property prior to other creditors. According to the Mortgage Law, the mortgage agreement shall be certified by the notary and registered in the state title registry (public register).

The mortgage is one of the most frequently used securities in banking finance transactions in Ukraine.

Construction project financing in Ukraine is often structured with a special type of mortgage collateral: an unfinished construction mortgage. The Mortgage Law provides three main options for the mortgage of real property the construction of which is incomplete as of the date of mortgage agreement execution:

a the mortgage of the unfinished construction (the mortgage of the unfinished construction *per se*);

b the mortgage of property rights to the unfinished construction; and

c the mortgage of title to the land plot underlying the unfinished construction (the drafting of the Mortgage Law leaves it unclear whether the mortgage of the land plot owned by the mortgagor falls into this category or creates the separate fourth category referred to in Article 6 of the Mortgage Law).

According to Article 16 of the Mortgage Law, the object of unfinished construction shall be mortgaged simultaneously with the mortgage of title to the underlying land plot. Pursuant to Article 331 of the Civil Code , the title to the unfinished construction shall be registered in the state title registry; such registration is a necessary precondition for execution of mortgage agreement.

VI LEASES OF BUSINESS PREMISES

Parties entering a lease agreement regarding commercial real estate in Ukraine are subject to certain mandatory provisions of Ukrainian law.

The Commercial Code stipulates that each lease agreement shall contain several essential terms to be agreed by the parties. Such terms are:

a a description of the leased property;
b the estimated value of the property;
c the term of the lease;
d the rent amount and its indexation;
e the depreciation of the leased property;
f recovery of the leased property; and
g the procedure for its transfer and acceptance or buyout by the tenant.

If the parties fail to mention any of these terms in the agreement, it shall not be considered as binding (*null ab initio*).

Any long-term lease agreement (three years and over) shall be certified by a notary. Leasehold title must registered in the state title registry to create a valid title.

Security of tenure is not recognised by Ukrainian civil law; however, tenants enjoy the pre-emptive right (right of first refusal) to prolong the lease and to buy the property.

VII DEVELOPMENTS IN PRACTICE

The main innovations and developments introduced by the Ukrainian Real Estate Law enacted on 1 January 2013 are presented below.

i Title registration system

According to the Real Estate Title Registration Law,[7] the authority to register title to real property passes from the Bureau of Technical Inventory and departments of the State Agency for Land Resources to the subsidiaries of the Ministry of Justice and notaries. The following is an outline of the new title registration system:

a Registration of buildings, apartments and land plots will be made in the Unified State Register of Rights to Real Estate (the Title Registry). Titles to land were previously subject to separate registration from the other real properties.

7 The Law of Ukraine on Public Registration of Titles to Immoveable Property and Encumbrances Thereof dated 1 July 2004 No. 1952-IV.

b The Title Registry will combine the registration of ownership (freehold) title with registration of mortgages, leases and other liens. These titles shall be registered in several separate registers.

c The ownership title to real property and other titles (mortgage, lease, *superficies*, servitudes, etc.) shall be effective upon registration in the Title Registry. Currently the public registration of mortgages is voluntary and does not have binding effect on the validity of mortgage agreements.

d The registration of title to real property and, therefore, its transfer, may be made conditional on facts or circumstances stipulated in agreements: a sale-purchase agreement may set forth the condition that registration of the buyer's title (i.e., transfer of ownership title to the buyer) shall take place only subject to payment of the purchase price. This may give more security to the seller. According to the law in force, the title to real property mandatorily passes to the buyer at the moment of notarisation of the sale-purchase contracts regardless of whether payment has been made. At present, parties have no option to set out conditions that create an imbalance between buyers' and sellers' transactional risks in contracts regarding transfer of real property. The new system will further secure sellers' interests.

ii Land cadastre

Pursuant to the Land Cadastre Law[8] adopted by Parliament in 2011, which was enacted as of 2013, Ukraine is making its first attempt to create a comprehensive unified database of land plots in the country, focusing primarily on the description of physical characteristics of the land; the Land Resources Committee and its local subsidiaries will set boundaries, assign cadastral numbers to plots and identify the designated purpose and permitted use (land zoning) of land plots. Free limited public internet access to the land cadastre data will be available at the website of the State Agency for Land Resources (although the names of landowners and tenants will remain private). The Land Cadastre Law also allows banks full access to review any information contained in the cadastre.

iii Moratorium over agricultural land

The last obstacle to termination of the moratorium on disposition of the major types of land plots designated for agricultural purposes still remains: the outgoing Parliament failed to adopt the Law on Land Market necessary for this reform under the provisions of the Land Code,[9] which strictly regulates the procedure for the sale and purchase of agricultural land. It is doubtful, therefore, that any progress will be seen in this area in the short term. At the end of 2012, Parliament elected to extend the moratorium until 2016.

iv Allotment of land plots for construction permitted

The Law of Ukraine on Amendments to Urban Development Law has been adopted. The Law suspends (until 1 January 2015) the moratorium on land allotment and changes of designated purpose of land in those areas where there are no zoning plans. The

8 The Law of Ukraine on Public Land Cadastre dated 7 July 2011 No. 3613-VI.

9 Item 15 of Section 10 of the Land Code.

moratorium was established by the Urban Development Law as of 1 January 2013. It did not allow the acquiring or leasing of land plots, or changes to the designated purpose of land for development purposes in cases where zoning plans had not been approved.

The Law came into force on 16 October 2013.

VIII OUTLOOK AND CONCLUSIONS

On 21 November 2013, the Cabinet of Ministers of Ukraine decided to suspend preparations to sign an Association Agreement (including a Deep and Comprehensive Free Trade Area) with the European Union.

According to the European Commission:

> *The EU is seeking an increasingly close relationship with Ukraine that goes beyond mere bilateral cooperation, encompassing gradual progress towards political association and economic integration. The EU takes note of the unprecedented public support in Ukraine for political association and economic integration with the EU and remains ready to sign the Association Agreement on the basis of determined action and tangible progress on the EU's benchmarks. To this end, important progress has already been achieved.*[10]

If the agreement had been signed in 2013, it would have had a considerable impact on Ukraine's national economy and on its real estate sector. However, Ukraine must overcome serious challenges to make further progress in integrating with the EU. Important challenges include the modernisation of the Ukrainian title registration system and land law, and improving private property protection. In this respect, key changes for implementation in Ukrainian law in 2014 will be the belated cleanup of the non-transparent tangle of Ukrainian real estate legislation. It is hoped that amendments to the legislation will improve the *status quo*, which at present fails to satisfy the demands of the national real estate market. Moreover, the advance of long-awaited reforms is a necessary step for Ukraine to join the EU.

10 Commission release: http://eeas.europa.eu/ukraine/index_en.htm.

Chapter 39

UNITED ARAB EMIRATES

Ibrahim Elsadig and Joe Carroll[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

The United Arab Emirates is a federation of seven emirates (Abu Dhabi, Dubai, Sharjah, Ras Al Khaimah, Umm Al Quwain, Ajman and Fujairah) with a civil law legal system. Under the UAE Constitution, the Supreme Council is the main federal authority (the federal government). It has the power to pass laws on the matters assigned to it by the UAE Constitution (federal laws).

Each of the emirates is governed by a ruler (the local government). The local government has the power to pass laws for their emirate (local laws) on matters not exclusively assigned to the federal government. Many local laws have been passed on matters where the federal government has the power to legislate, but has not done so, and the local government has considered regulation necessary.[2]

Under federal law, local governments can pass local laws establishing free economic zones (free zones) within their emirate. Each free zone has its own rules and regulations that will apply within its borders (free zone regulations).

As a consequence, the laws of the UAE consist of a patchwork of federal laws, local laws and, within the free zones, free zone regulations. This chapter focuses on the real estate laws applicable in the emirates of Abu Dhabi and Dubai, the largest and most populous of the emirates.

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1 Ibrahim Elsadig is a partner and Joe Carroll is an associate at Dentons.

2 This is compatible with Articles 123, 125 and 149 of the UAE Constitution, which provide that the local governments may promulgate local legislation necessary for the regulation of matters within the exclusive legislative jurisdiction of the federal government, provided they comply with the Constitution and other federal legislation.

The federal law sets out a number of principles regarding real property and the rights that relate to it. The Law of Civil Transactions of the UAE (the Civil Code)[3] is the primary source. Part 1 of the Civil Code deals with the application of laws in the UAE and the types of rights that are recognised by law. Part 4 deals specifically with property rights, setting out how they can be acquired and the rights that derive from ownership. Part 5 deals with the creation of security over all types of property (including real property).

In addition, each local government has introduced local laws regarding real property and the rights that relate to it.[4] Abu Dhabi and Dubai each have their own legal and regulatory frameworks. Dubai has introduced the most progressive laws and is widely recognised as a pioneer among the emirates.

Within each free zone, it is necessary to consult the free zone regulations and local laws that specifically relate to it. The Dubai International Financial Centre (the DIFC), for example, has its own property laws, register of property rights and forum for hearing disputes.

i Ownership of real estate

In the UAE, interests in real property and rights relating to it (property interests) may be characterised as either property rights (such as freehold) or contractual rights (such as short leasehold). The most common property interests are:

a freehold: the most complete form of ownership, with the owner having full rights to the property unlimited in time (a property right);[5]

b usufruct: a right to use property for a limited period (a property right);

c *musataha*: a right to use land for a limited period and to construct buildings thereon (a property right); and

d leasehold: a right to use property for a limited period (which may be a property right or a contractual right, depending on the presence of factors denoting a property right, such as the length of the term).

In Abu Dhabi and Dubai, local laws and practices limit the acquisition of property rights according to the nationality of the investor.[6] Nationals of the UAE are not subject to any restrictions. Nationals of a member state of the Gulf Cooperation Council (the GCC) other than the UAE may be subject to some restrictions. Persons falling outside both categories (foreign nationals) will find that they are subject to the greatest restrictions. The local government does, however, reserve the right to disapply these restrictions in

3 Federal Law No. 5 of 1985.

4 Federal laws are superior to local laws and should be accorded primacy in the event of conflict. If a matter is not dealt with by either body of laws, shariah law will be applied.

5 While the term freehold is commonly used, there is no federal law defining the meaning of this term.

6 For legal persons, nationality is determined by reference to the country of incorporation and the nationality of its shareholders.

specific areas on a case-by-case basis. Barring the free zones, the least restrictive areas in Abu Dhabi and Dubai are those known as investment zones and freehold areas.

ii Registration of property interests

The requirements and procedures for registration are set out in the local laws, which differ between the emirates. Without registration, the creation of a property right in the name of the purported owner will not be perfected. None of the emirates provides a state guarantee of title.

In Abu Dhabi, property rights should be registered with the Department of Municipal Affairs (Abu Dhabi Municipality) on its land register. The owner of a property then receives a title certificate as proof of ownership.[7] Short leases (i.e., contractual rights) should be registered with Abu Dhabi Municipality on its register of tenancy contracts (Tawtheeq).[8]

In Dubai, property rights should be registered with the Dubai Land Department on its land register. The owner of a property then receives a title certificate as proof of ownership. Short leases (i.e., contractual rights)[9] should be registered with the Real Estate Regulatory Authority (RERA) on its register of tenancy contracts (Ejari). Contracts for properties purchased off-plan should be registered with the Dubai Land Department on its register of off-plan properties.

iii Choice of law

Under the Civil Code, possession, ownership and other rights over real property[10] and contracts dealing with them[11] are governed by the laws of the emirate in which the property is situated (i.e., the *lex situs*). Local laws will also determine whether the matter in question relates to rights over real property.[12]

II OVERVIEW OF REAL ESTATE ACTIVITY

The governments of Abu Dhabi and Dubai have taken significant steps towards the liberalisation and diversification of their economies. Historically, Abu Dhabi (holding the greatest proportion of hydrocarbon reserves) was the focus of the UAE's industrial activities. Lacking the hydrocarbon wealth of Abu Dhabi, Dubai embarked on a massive programme of real estate development to accelerate the diversification of its economy. Abu Dhabi has also followed this path to supplement its traditional activities.

As a result of these initiatives, real estate projects (including infrastructure, residential, hotel, leisure, retail, office and industrial sectors) have grown rapidly. The

7 Very little registration has taken place other than for UAE nationals.

8 There are certain exceptions from the registration requirement, depending on the use to which the property is put.

9 Ibid.

10 Article 18 of Federal Law No. 5 of 1985.

11 Article 19(2) of Federal Law No. 5 of 1985.

12 Article 18(2) of Federal Law No. 5 of 1985.

investment zones (Abu Dhabi), freehold areas (Dubai) and free zones (with their advantageous corporate and tax regimes) were integral to this development.

Despite the transformation that is underway in the UAE, the number of institutional investors has remained low. It is fair to say that the pace of growth has been rapid and the legal and regulatory systems have required time to develop and mature. As a consequence, the majority of participants in the market are government-related entities and private investors (with significant numbers from, *inter alia*, Canada, India, Iran, Pakistan, Russia and the United Kingdom).

During the global economic slowdown, purchase prices and rents for some properties fell by as much as half (and sometimes more). As existing and new projects reached completion, so oversupply exerted additional downward pressure on prices. After several years of suppressed prices and market activity, there has been a noticeable return of confidence to the market. The Arab Spring highlighted the relative stability of the UAE (in contrast to nearby states). With the local economy showing signs of a sustained recovery, so demand for property has steadily grown with prices and rents increasing. This trend is expected to continue following Dubai's successful Expo 2020 bid.

The pace of change has led some to question whether the increases represent real value or evidence of a new bubble in the market. In Dubai, figures show that property prices in some areas have risen by 20 per cent to 50 per cent when compared with the previous year. As a consequence, the price differential between Dubai (traditionally less expensive) and Abu Dhabi has narrowed significantly.

III FOREIGN INVESTMENT

There are restrictions on foreign investment in UAE property that vary according to the nationality of the investor and the location of the property.[13] The restrictions attach to both natural and legal persons. Since the restrictions are not laid down in the federal law, it is necessary to consult the local laws and practices of each emirate.

i Foreign ownership in Abu Dhabi

Local law provides that foreign nationals, and companies owned in whole or in part by them, can own certain property rights in designated investment zones of Abu Dhabi. The available property rights include ownership of apartments and floors in buildings (with no right to the underlying land) and rights of usufruct, *musataha* and long leasehold. The investment zones include Al Raha Beach, Reem Island, Saadiyat Island and various other projects. By way of exemption, the local government can authorise ownership outside the designated investment zones on a case-by-case basis.

GCC nationals (other than UAE nationals) can own the same property interests as foreign nationals within the investment zones and, in addition, freehold within the investment zones. UAE nationals, and companies wholly-owned by them, can own any of the recognised property interests throughout all of Abu Dhabi.

13 See Article 298 of Law No. 11 of 1992 (the Federal Civil Procedures Law).

ii Foreign ownership in Dubai

Local law provides that foreign nationals, and companies owned in whole or in part by them, can own property rights in the designated freehold areas of Dubai. The freehold areas include the Palm Jumeirah, Jumeirah Lakes Towers, Dubai Marina, Downtown Burj Khalifa, Arabian Ranches, the Lakes, the Springs, the Meadows and various other projects. Again, the local government can authorise ownership outside the designated freehold areas on a case-by-case basis.

UAE and GCC nationals, and companies wholly-owned by them, can own any of the recognised property interests throughout Dubai.

The above must be read in light of the Dubai Land Department's circulars on registration of property rights by offshore companies (see Section VII.iv, *infra*).

IV STRUCTURING THE INVESTMENT

Property assets will often be acquired by a special purpose vehicle (SPV) in order to ring-fence liability and protect the asset from the risks associated with the operation of the business. The choice of investment structure may also be guided by considerations such as:

a optimum legal ownership;
b the ability to co-invest with funders;
c the ability to include joint venture partners;
d the ability to benefit from foreign insolvency or trust regimes;
e mitigation of tax or transfer fees;
f compliance with the principles of shariah law; and
g avoidance of inheritance issues.

The chosen structure (e.g., *ijara* finance) should be formulated in light of the restrictions on foreign ownership and the requirement to register property rights (in order that they may be effectively created). In Dubai, for example, local laws provide that any attempt to circumvent the foreign ownership restrictions will be null and void. Any interested party, including the Dubai Land Department and Dubai's Public Prosecutor, can request the setting aside of an avoidance structure.[14]

i Free zone companies

Foreign nationals, and companies owned in whole or in part by them, may choose to incorporate a UAE free zone company to hold rights over property within that zone. In Dubai, for example, freehold properties are now available in Jumeirah Lakes Towers, which forms part of the free zone overseen by the Dubai Multi Commodities Centre. It is now also possible for an offshore company incorporated in the Jebel Ali Free Zone to register title to property rights in Dubai's freehold areas (outside the borders of the Jebel Ali Free Zone).

14 Article 26 of Dubai Law No. 7 of 2006.

ii Unregistered leases

Foreign nationals, and companies owned in whole or in part by them, may choose to enter a long lease over a property that is located outside a freehold area. To do so is not thought to be illegal, but it will not be possible to register the lease. These interests have been interpreted as personal rights whose legal effect will be limited to contractual obligations between the parties. The status of these interests is somewhat uncertain given the initiative to register all leases (involving both contractual and property rights), withdraw the assistance of adjudicating authorities in cases in which registration should have been completed and require that company registrations and applications for utilities connections be accompanied by a registered lease.

iii Offshore special purpose vehicles

In Abu Dhabi, an offshore SPV can hold and invest in property assets located in the investment zones. In Dubai, the Dubai Land Department has issued guidance that prevents the registration of property rights by all offshore entities other than those incorporated in the Jebel Ali Free Zone that have individuals as shareholders (see Section VII.iv, *infra*).

iv UAE (Abu Dhabi or Dubai) companies

A UAE company can hold a property asset outside a freehold area where its shareholders are purely UAE nationals (for property located in Abu Dhabi), or UAE or GCC nationals (for property located in Dubai). A UAE company can also be used by foreign nationals to hold property assets in the freehold areas of Dubai; they will, however, be subject to any limits on foreign ownership of shares. A UAE company cannot acquire property rights in Abu Dhabi (outside the investment zones) if it has any non-UAE shareholders; nor will it be able to acquire property rights in Dubai (outside the freehold areas) if it has any non-GCC shareholders.

v Trusted owners

Should a foreign person wish to exercise effective control over a property situated in an area where it does not qualify for ownership, it may consider the trusted owner structure. A UAE national or company will hold legal title to the property on behalf of the beneficial owner. As well as the attendant risks involved in holding beneficial (not full legal) ownership, it is arguable that this method of ownership breaches UAE law and as such may be unenforceable.

V REAL ESTATE OWNERSHIP

i Planning

Abu Dhabi Municipality and Dubai Municipality oversee development, building regulations and planning controls (including change of use) in their respective emirates. Buildings within an investment area, freehold area or free zone may also be subject to the regulations and controls of the master developer or regulatory authority for that area. Local licensing requirements should also be observed. For example, a developer wishing to establish a new project in Dubai must first register itself with RERA.

ii Environment

Environmental law comprises laws at the federal and local levels. A number of international conventions and protocols are recognised. Federal law controls all forms of pollution and applies the polluter pays principle. There are substantial penalties for polluting the environment.

Developers must identify areas of environmental importance or sensitivity and which of their activities may cause harm.[15] They must also undertake an environmental impact assessment for their project.[16]

Because environmental liabilities may pass with ownership of land, a prospective purchaser of land should include appropriate warranties from the seller in the purchase agreement (against which the seller should disclose any issues) and consider whether physical inspection and testing of the land should be conducted.

In Abu Dhabi, the competent authority is the Environment Agency – Abu Dhabi. In Dubai, the competent authority is the Environment Department of Dubai Municipality. Activities within an investment area, freehold area or free zone may be subject to the regulations and controls of the master developer or regulatory authority for that area.

iii Tax

No value added tax (or equivalent) or stamp duty is payable on the sale or purchase of real estate. Fees are payable in respect of registration of property interests. There may be other costs associated with ownership or occupation. In Dubai, for example, business occupiers must pay a trade licence renewal fee (5 per cent of the annual rent) and hospitality businesses, such as hotels, must pay a municipality tax (10 per cent of turnover). Free zones may apply their own charges in respect of such matters.

iv Finance and security

A common form of security over UAE real estate is a mortgage. Federal law outlines the basic principles regarding the creation of security over real property. If the mortgage is validly created, the mortgagee will acquire a property right and will take precedence over ordinary creditors and creditors subsequent in rank to him in satisfaction of the debt from the proceeds of sale.

In Dubai, a law dealing specifically with mortgages has been introduced.[17] This requires that all mortgages be registered with the Dubai Land Department; the mortgagee be a bank, company or financial institution licensed and registered by the UAE Central Bank; and the mortgagor be the owner of the property interest and able to dispose of it. Priority is determined according to the time that the mortgage was registered.

15 Article 3 of Federal Law No. 24 of 1999 for the Protection and Development of the Environment.

16 Article 4 of Federal Law No. 24 of 1999 for the Protection and Development of the Environment.

17 Dubai Law No. 14 of 2008.

In Abu Dhabi, there is no specific law dealing with mortgages of real property. Registration law in Abu Dhabi does, however, recognise the right for mortgages to be created (over property and property rights inside and outside the investment zones) and requires the registrar to record these on the land register maintained by Abu Dhabi Municipality.[18] Actual registration of mortgages reflects the overall registration of property interests in Abu Dhabi (mostly completed by UAE nationals outside the investment zones). Consequently, many lenders have chosen to utilise an unregistered mortgage combined with a conditional assignment of the borrower's rights to the property. Should the borrower default, the lender will exercise its step-in rights and take control of the property.

VI LEASES OF BUSINESS PREMISES

Common features of the leasing process include documents and terms of occupation that are relatively short, clauses that are landlord-friendly and an unwillingness (often refusal) on the part of landlords to accept tenant amendments.

In the past, with good space at a premium, tenants often had little choice but to accept the terms offered. Once in occupation, and with rents continuing to rise, renewal could be uncertain. With no security of tenure or limit on rent increases, landlords held the upper hand.

Abu Dhabi and Dubai responded with legislation and institutions (at the local level) to regulate the landlord and tenant relationship applicable to both the residential and commercial sectors. The global economic slowdown saw landlords increasingly likely to offer inducements and agree amendments to their standard terms.

i Lease negotiations

It is common to encounter leases of just a few pages in length that set out only basic terms. A standard template of lease terms is frequently used for residential and small or basic commercial units (e.g., warehouses). As the market has matured, the use of legal representation and more sophisticated leases has increased.

Provided the general law and any specific landlord and tenant laws are observed, the terms of leases can be freely negotiated. In Abu Dhabi, the new Tawtheeq registration system aims to standardise leases with the introduction of a standard lease template and section for special conditions. A lease will not be accepted for registration if the special conditions contradict the law. In Dubai, RERA has also released a standard template for residential properties.

ii Term of occupation

The maximum permissible term of occupation is 99 years. Terms are generally much shorter (under 10 years) and supplemented by an option or presumption of renewal.[19]

18 Abu Dhabi Resolution No. 64 of 2010.

19 Rights of *musataha* (cf leasehold) should not exceed 50 years but are renewable.

Leases often require that advance notice must be served to terminate the lease at the expiry of the contractual term.

In Abu Dhabi, local law imposes a presumption of renewal but no security of tenure. What this means is that the landlord can freely terminate the lease at the end of the term but it must serve the minimum period of notice required by law (which differs for residential and commercial property). It is no longer a requirement of local law that the landlord must establish a permitted ground for non-renewal. If the tenant remains in occupation, without objection from the landlord, then the lease will renew for a similar term.

In Dubai, local law imposes both a presumption of renewal and security of tenure protection. If the landlord does not establish a permitted ground for non-renewal, then the lease will automatically renew on the same terms and for the same period or for one year (whichever is shorter). A party wishing to vary a term of the lease should serve notice on the other not less than 90 days before the expiry of the lease. If a variation cannot be agreed, the matter can be referred to Dubai's Rent Dispute Settlement Centre for determination.

iii Rent and review

Leases commonly provide for an annual rent review.

In Dubai, local laws limit the maximum increase that a landlord can apply (known as the rent cap). Unless a lease specifies the actual rent payable for each year of the term (i.e., a stepped rent), then annual increases (during the term or on renewal) will be subject to the rent cap. The maximum increase that can be applied ranges between 5 per cent and 20 per cent of the annual rent, depending on how low the rent is compared with the average for similar properties.[20] The rent must be more than 10 per cent below the average to qualify for an increase of 5 per cent.

In Abu Dhabi, the rent cap (of 5 per cent per year) was recently removed. Rent review is now a matter for agreement between the parties to the lease.

iv Repair

In Abu Dhabi, the law obliges the tenant to carry out those simple repairs that, by convention, fall to be carried by the tenant. In Dubai, the law obliges the tenant to return the premises to the landlord in the condition it was in at the beginning of the term, subject to normal wear and tear. In both instances, the landlord must carry out any repairs necessary to maintain the structure and ensure the premises are fit for use.

v Subletting and assigning the lease

Many leases focus on the prohibition of unauthorised subleases. In both Abu Dhabi and Dubai, the law provides that the landlord's prior written consent must be obtained before a lease can be assigned or a subtenancy granted.

20 Dubai Decree No. 2 of 2011.

vi Termination

Until recently, local law in Abu Dhabi imposed a presumption of lease renewal (up to a certain maximum number of years). These tenant protections have now been removed, with the consequence that lease renewal will now be a matter for agreement between the parties to the lease.

In Dubai, there are separate sets of grounds depending on whether the landlord wishes to terminate the lease during or at the end of the contractual term. In the case of the former, grounds include non-payment of rent by the tenant, and in the case of the latter, include the landlord's right to redevelop the property.

In both Abu Dhabi and Dubai, the tenant does not have the right to terminate prior to expiry of the term unless the lease contains a break right or the landlord agrees to early termination.

VII DEVELOPMENTS IN PRACTICE

i Abu Dhabi – security of tenure

Local law in Abu Dhabi previously included security of tenure provisions (up to a maximum number of lease years). In 2010, a law was passed entitling landlords to refuse renewal at the end of the lease term without being required to establish one of the permitted grounds for preventing renewal (such as requiring the property for its own use). The law included a grace period before this change would take effect, which expired on 9 November 2013. Provided the landlord serves the minimum period of notice required by law, it can terminate the lease (at will) at the end of the term.

ii Abu Dhabi – rent cap

The rent cap in Abu Dhabi, which was previously renewed by the local government on an annual basis, was allowed to expire without renewal. Consequently, rent reviews will now be a matter for agreement between the parties to the lease.

iii Abu Dhabi – government worker housing policy

A decree issued in 2012 required that all public sector employees reside within the emirate, with employees that fail to do so being at risk of losing their housing allowance. A grace period of one year was granted before such a sanction would be imposed. As the September 2013 deadline for relocation approached, so the number of people moving to the capital (principally from Dubai) increased. Due to higher living costs in Abu Dhabi, however, significant numbers of employees (particularly from the private sector) continue to commute between the two emirates.

iv Dubai – property registration by offshore companies

The Dubai Land Department has issued guidance that prohibits the registration of property rights by all offshore entities other than those incorporated in the Jebel Ali Free Zone that have individuals as shareholders. Notwithstanding the general prohibition, the Dubai Land Department has reserved the right to allow such registrations to proceed (in its discretion) on a case-by-case basis.

The new regime is intended to prevent the transfer of property rights without the Dubai Land Department being able to identify the new owners and receive a fee for the property transfer. Previously, property transfer fees could be avoided by simply selling shares in the foreign company. The Dubai Land Department and Jebel Ali Free Zone Authority are now cooperating to exchange information on transfers of shares and apply the appropriate fee to transactions that are effectively property transfers.

Since these developments impose significantly different requirements from those set out in the local laws, it is hoped that the local government will issue primary legislation clarifying the extent of these prohibitions on registration.

v Dubai – change in land registration fees

Two key changes in transaction fees were introduced in the past year. The first was an increase in the rate of the transfer fee for freehold properties from 2 per cent to 4 per cent of the property value. The second was a change in the way transfers fee would be calculated for land on which warehouse properties are situated. Instead of the previous 2 per cent charge, the fee will now be calculated at 10 dirhams per square metre (subject to a minimum fee of 10,000 dirhams). A new fee schedule has also been issued, which now includes powers for the Dubai Land Department to impose fines on those it has identified as being guilty of fee evasion.

vi Dubai – judicial committee for cancelled projects

A judicial committee has been established to liquidate cancelled real estate projects and distribute their assets between purchasers and creditors. Investors seeking redress will no longer need to bring individual cases against failed developers (class actions are generally not available). Instead, a global solution for each project will be delivered, with associated time and cost savings. However, since developers were originally liable for any shortfall in funds required to repay project investors, it does appear that investors may be required to forego full reparation in exchange for the release of the remaining project funds.

vii Dubai – mortgage caps

The UAE Central Bank has issued new rules on the permissible loan-to-value ratio of mortgages. Home loans for expatriates are now subject to a cap of 75 per cent of the property's value (for a first investment under 5 million dirhams). For UAE nationals, the cap is set at 80 per cent. Additional restrictions apply for more expensive properties and for second and subsequent investments. Mortgages for off-plan properties will be capped at 50 per cent. The new regime is expected to come into effect in early 2014.

viii Dubai – draft investor protection law

The draft investor protection law was issued in 2012, with implementation scheduled to take place by the end of 2012 or early in 2013. The draft has not become law yet. The Dubai Lands Department maintains that implementation is still to be expected soon. The draft law specifies a number of additional protections for investors, including:

a the seller's liability to disclose rights and restrictions affecting the property;

b the seller's liability for representations made during the sales process;

c the investor's right to review the sale and purchase agreement and recover its deposit if the agreement is not acceptable;

d the investor's right to compensation or cancellation and a refund in instances of late handover or variation of property specification (depending on the severity of the delay or variation); and

e the investor's right to a refund or replacement of its property with another if its property has a substantial defect.

The draft law also permits developers to retain control of building management on the condition that this is specified in the sale and purchase agreement. This will be welcomed by operators of branded residences. It remains to be seen whether the current requirement to establish not-for-profit owners associations will be protected or could become optional. The final wording of this and other provisions will be closely scrutinised on the issuance of the final law.

ix Dubai – rent cap

A new rent cap has been issued, which clarifies that the maximum increases of rent will now apply to all free zones, including the DIFC.

VIII OUTLOOK AND CONCLUSIONS

In Abu Dhabi, the local government is continuing its longstanding review of its property laws. Despite the various protections that exist under those laws, investors do not benefit from the breadth of property rights (such as freehold for foreign nationals) or protection measures (such as registration of off-plan properties, escrow law protecting payments for off-plan properties and easy registration of title and mortgages) that are available under Dubai law.

In Dubai, the local government is looking to refine its regulatory system and promote a sustainable recovery in the local property market. It has recognised some of the challenges facing investors and is taking steps to identify and implement solutions. Higher property transfer fees and stricter rules on mortgages have already been introduced to make speculation and property 'flipping' less attractive. A draft investor protection law has been issued, to provide additional protections for future investors once it becomes law, whilst the new commission on cancelled projects will begin to distribute assets among existing investors who bought into projects that did not survive the economic slowdown.

These advances are to be welcomed as the next steps in the development of a comprehensive and mature regulatory framework in the region. It is hoped that Abu Dhabi, with the advantage of being able to assess the strengths and failings of the measures introduced in Dubai, will soon release solutions tailored to its own market.

Chapter 40

UNITED STATES

Meredith J Kane[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

Investors in US commercial real estate should be familiar with both the type of investment entity that is used for the interest in real estate being acquired by the investor, and the type of ownership interest that the investment entity holds in the underlying real property.

i Ownership of real estate

Investors typically hold their interests in US commercial real estate through the following investment entities: a limited liability company (LLC), a limited partnership (LP), a real estate investment trust (REIT), a tenancy in common (TIC) or direct investment. Each of these investment entities is discussed further in Section IV, *infra*.

The investment entities in turn own the underlying real property asset. The most common forms of ownership of US commercial real estate are fee simple title and ground leasehold title.

In fee simple title ownership, the ownership entity owns all right, title and interest in the real estate asset, including the right of free alienation of the asset. The fee simple estate is not limited in duration, and there is no superior titleholding estate. A fee simple estate is subject only to liens and encumbrances that are superior to the estate by reason of an express grant of priority by the fee simple owner, such as a mortgage or an easement that expressly encumbers the fee simple estate.

Where a fee simple owner wishes to convey a long-term interest in the real estate asset to a third party but wishes to retain the underlying fee title, typically for reasons of taxes or inheritance, the fee owner will commonly enter into a long-term ground lease that will enable a third party to lease, develop and operate the real estate on the lessee's

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account. Ground leases are usually of at least 49 years' duration, and often 99 years or longer. Such long terms are necessary for the ground lessee to finance the development of the real estate and to amortise its equity investment in development of the real estate. A ground lease is a fully net lease, where the lessee develops, finances, operates, maintains and insures the property for its own account. Financing for the acquisition and development of the leasehold interest is secured solely by the lessee's interest in the ground lease, and not by the fee interest itself, which remains superior to the lease and the financing. From the standpoint of the safety of a real estate investment, a ground landlord's position under a ground lease, where the lessee has invested in improving the real estate, is among the most secure investments available.

ii System of registration

The system of registration of real estate titles is governed by the laws of each state. The land title registries for each state are administered by local governments – city, town or county – which are subsidiary governmental jurisdictions in each state. Title registration occurs through the recording of deeds, easements, mortgages and other encumbrances in the local registry offices when a transaction is closed. Recording of title documents is necessary to establish priority and right in estate over another competing interests in the same property. It is customary for a buyer or a lender in US real estate transactions to engage a title insurance company at the time of entering into a contract to purchase property to examine the local title registries to determine the ownership of real estate and any encumbrances of record, and to engage a surveyor to determine land boundaries and locations of improvements and easements. At the closing of title transactions, it is customary to purchase title insurance to insure that good title is being acquired by the purchaser, subject only to identified encumbrances. Title insurance is also required by most mortgage lenders, to insure that the lender's mortgage is a first priority lien on the real estate. The premiums for title insurance vary by state, as do specific endorsements that title insurers are permitted to underwrite. Many state and local governments impose transfer and recording taxes and fees on the transfer or recording of real property titles, based on the dollar value of the consideration paid for the real estate being transferred. Transfer taxes can range from a few tenths of a percentage point to up to more than 3 per cent.

iii Choice of law

The laws of each state govern the legal frameworks of both investment entities and ownership estates in real property. There is no federal law of real estate applicable uniformly throughout the US to investment entities or forms of ownership in land, other than the commonality of federal income tax law, which helps shape the investment entities used. There is, however, a relatively high degree of uniformity in the state laws governing investment entities, as both limited partnerships and limited liability companies are governed by uniform acts written by uniform law commissions, which have been adopted with little variation as the laws of each state.

Choice of law in real estate transactions can vary based on the transaction document in question. Ownership entities will usually be established either under Delaware law (which has become the standard for sophisticated financing transactions, including securitised financing) or the law of the state in which the real estate is located.

One advantage to forming an entity under the law of the state where the real estate is located is that a Delaware entity will also need to register to do business in the state in which the real estate is located.

Choice of law for deeds and title transfers is always that of the state where the real property is located. For financing transactions, it is common for there to be a split in governing law. Notes and loan agreements are often governed by New York law, which has become a standard commercial jurisdiction for lenders, while security documents, such as mortgages and UCC (Uniform Commercial Code) financing statements, are always governed by the law of the state in which the real estate is located. It is important in mortgage transactions for the lender and borrower to retain local counsel in all states where the mortgaged property is located to ensure that the mortgage documents meet state law requirements and are in proper format to be recorded in the local title registries and enforced under state law.

II OVERVIEW OF REAL ESTATE ACTIVITY

The US real estate market is now four years into a recovery that began in 2009. Several factors caused a surge in values and activity in US real estate in 2013:

a the continued low long-term interest rates and quantitative easing monetary policies of the US central bank;

b job growth in many sectors, including business services and energy, driving the demand for more office space and residential rental properties;

c the relative lack of return opportunities in other investment sectors; and

d the attractiveness of the US markets to overseas investors looking for a stable, safe haven for their funds.

The large amount of investment capital seeking real estate deals has led some observers to conclude that real estate, particularly in the gateway cities of New York and San Francisco, may again have reached unsustainably high bubble prices.

The restructuring of large and small loans and equity investments throughout all asset classes that has dominated the US real estate markets since 2008 continued in 2013, and is expected to be relatively smooth in 2014. Restructuring activity is anticipated to peak during the period from 2015 to 2017, as approximately US$350 billion in 10-year maturity commercial mortgage backed security debt (CMBS) will need to be refinanced.[2] The pattern of recapitalisations in recent years has employed substantial new equity infusions, as leverage levels have decreased from first mortgage loan amounts that were commonly at 70 to 75 per cent for stabilised commercial properties in the mid-2000s, to levels closer to 50 to 60 per cent in today's refinancing markets. The primary sources for debt refinancing in 2013 were banks, insurance companies and REITs, as CMBS market continued at levels still significantly below the 2007 peak. In 2013, total CMBS issuances were approximately US$90 billion, up from US$50 billion in 2012 and only US$32.7 billion in 2011. Sources anticipate that new CMBS issuances, particularly

2 Source: Trepp LLC, Real Estate Finance Intelligence, 31 December 2013.

for large loans, may top US$125 billion in 2014, which is still just over half of the US$237 billion issued in 2007.[3] New regulations adopted under the federal Dodd-Frank Financial Reform Act require that issuers retain a minimum of 5 per cent of the risk in future CMBS issuances, which is expected to continue to constrain securitisation capacity.[4]

Equity activity in real estate increased sharply in 2013 as investors sought yield, and equity was in demand to cover gaps in the capitalisation structure brought about by lower property valuations and reduced loan-to-value ratios. Institutional equity commitments to real estate from pension funds, foundations and endowments grew 9 per cent in 2013 to total over US$880 billion worldwide, with US institutional real estate equity assets at approximately US$326 billion.[5] Institutional investors focused on core properties, often in open-ended fund structures. Core properties, being the most high-quality, well-leased income-generating assets in major cities including Boston, New York, Washington DC and San Francisco, have as a class yielded annual income returns in excess of 5 per cent, as compared with 10-year Treasury yields of 2.5 per cent. Taking into account capital appreciation, a key index of open-end core funds shows three-year annualised returns of 13.85 per cent.[6] For 2014, pension investment managers are predicting increased investment in riskier properties, as tremendous demand for core properties is driving down yields.

New development activity in New York City reached a 10-year high. Over 4.1 million square feet of new office space came on the market, in the midtown west and downtown markets. Office vacancies dropped a full percentage point over the year to a 10.8 per cent availability, and average asking rents increased by over 10.2 per cent from 2012. Several large office leases were signed at new office development at Manhattan's Hudson Yards and World Trade Center complexes.

III FOREIGN INVESTMENT

The US commercial real estate markets remain an attractive investment target for foreign capital seeking a stable political environment and stable currency. The market downturns of the past few years mean that commercial real estate remains a relatively attractively priced asset, with the potential to generate substantial operating income and capital gains as markets continue to improve. The major source of foreign capital was from Chinese investors, who collectively invested US$2.88 billion in US real estate assets in 2013, up from US$321 million in 2012.[7] The Chinese investors, unlike the other sovereign wealth funds, invested heavily in new development projects, including high-profile mixed-use projects in New York and Los Angeles, where yields can top 15 to 20 per cent. The top four of the five global cities for foreign investment dollars are in the US: New York,

3 Source: Cantor Commercial Real Estate, Real Estate Finance Intelligence, 31 December 2013.

4 Source: Real Estate Roundtable, 2013 Annual Report, Capital and Credit Policy.

5 Source: Pensions & Investments Annual Survey, 28 October 2013.

6 Source: NCREIF NFI-ODCE Index, 30 June 2013.

7 Source: Bloomberg BusinessWeek, 19 November 2013.

San Francisco, Washington, DC, and Houston. (London was the fifth.) The most popular asset type for foreign investments in US real estate, apart from development, is multifamily, followed closely by retail, industrial and office.[8] The inclusion of San Francisco and Houston on this list, in addition to the traditionally strong office and multifamily markets of New York and Washington DC (home to financial services and government sectors, respectively), shows the expectation that the technology and energy sectors will lead job recovery in the next several years. However, foreign investment in luxury US residential real estate dipped slightly in 2013, as slowing economies in China and Brazil have slowed luxury individual condominium purchases in the US.

i Foreign Investment in Real Property Tax Act (FIRPTA)

Foreign investment in US commercial real estate is generally done through a US-taxpaying entity to avoid the withholding tax provisions of Internal Revenue Code Section 897, FIRPTA. The most commonly used US-taxpaying entity for foreign investment is a US corporation that is a wholly-owned subsidiary of the foreign investor. As with LLCs and LPs, corporations are also organised under state law, usually either Delaware or that of the state in which the real estate is located. The foreign investor is thus subject to US income tax with respect to the ownership and operations of US real estate, including capital gains taxes on dispositions. While there have been several legislative initiatives to repeal FIRPTA over the past few years to encourage foreign investment in US real estate, it remains in effect.

Loan activity by a foreign lender to an unrelated US borrower, where the lender is domiciled outside of the US and where the loan is sourced and negotiated outside the US, is not subject to US withholding tax.

ii EB-5 immigration programme for investment in job creation

An incentive for foreign investment which has become increasingly widespread in use over the past five years is the EB-5 programme, under which a foreign national becomes entitled to receive an employment-based fifth preference (EB-5) immigrant visa in return for investing in a new commercial enterprise within a US government-designated regional centre. The required investment is US$1 million of foreign capital, which is reduced to US$500,000 for an investment in an area of high unemployment or in a rural area. The investment must create at least 10 full-time US jobs. The EB-5 investment is structured either as a preferred equity investment with a fixed return, or as secured debt. EB-5 investment has become a primary source of low-cost investment capital for real estate development projects, where jobs are generated through construction activity as well as business occupancies.

IV STRUCTURING THE INVESTMENT

Real estate ownership is typically structured so that an entity with limited liability is the owner of the direct fee title or ground leasehold interest in the real estate. The investors

8 Source: Co-Star, 9 January 2013, citing Association of Foreign Investors in Real Estate survey.

hold interests in these entities, rather than directly owning the title to the real estate. The most common types of limited liability entities that own real estate assets are the LLC, the LP and the REIT.

LLCs and LPs are organised under state laws, most commonly either Delaware law or the laws of state in which the real estate is located. An LLC is managed by a manager or a managing member, and an LP is managed by a general partner. The investors are typically non-managing members or limited partners in the property-owning entities.

A major advantage of an LLC or LP structure is that an investor is not liable for the debts or liabilities of the title-holding entity beyond the funds invested in the entity. Thus, an investor is insulated from property liabilities through this investment structure, including property-level debt. A second major advantage is that both LLCs and LPs are pass-through entities for federal income tax purposes, meaning that all income and losses of the entity are passed through to the members and taxed solely to the members, with no second level of tax at the entity level. Investors can use income and losses of the property to offset income and losses of other real estate investments for tax purposes, and tax-exempt investors can enjoy fully tax-exempt income.

Typical provisions of the LP or LLC agreement describe:

a the capital contributions of the parties, obligations, if any, of the parties to contribute additional capital to the entity, and rights and remedies if a party fails to make required future contributions;

b the decision-making process of the entity, including major decisions that will require approval of all or a majority of the investors;

c the timing and priority of distributions of available cash and capital proceeds to the parties, including preferred returns and carried or promoted interests;

d allocations of income, gain and loss for tax purposes; and

e exit rights of the parties, including buy-sell rights, forced-sale rights, and provisions governing sales of interests and rights of first offer or refusal.

Another relatively common structure for ownership of real estate is the REIT. This structure, defined by Section 856 of the Internal Revenue Code, is used to hold interests in real estate where maximum liquidity is desired. The REIT is organised as a corporation with shareholders, in which the shares may be publicly or privately traded. To enjoy a pass-through tax treatment similar to LLCs and LPs, a REIT is required to meet prescribed IRS requirements, including that it distribute 95 per cent of its taxable income annually, that it invest at least 75 per cent of the value of its total assets in real estate or real estate mortgages, and that it derive at least 75 per cent of its gross income from real property rents, interest, proceeds of sale and similar. Most REITs traded on the US markets today are large corporations with multiple property holdings, usually in a single asset class (residential or office), but often in multiple geographic markets to provide asset diversification to REIT investors.

In addition to their advantages as pass-through tax entities, REITs enjoy an advantage in the marketplace for acquisitions because of their ability to finance acquisitions relatively inexpensively. Although REITs are not permitted to retain earnings, REIT property acquisitions are financed with corporate lines of credit, which provide a relatively less expensive source of financing than property-level debt or by issuance of new stock.

V REAL ESTATE OWNERSHIP

i Planning

Planning and land use issues are largely controlled by states and municipalities through the mechanism of zoning laws adopted by local jurisdictions. In rural and suburban areas, zoning laws focus on master plans for large-scale developments and related infrastructure, with a focus on controlling density, preserving open space, and ensuring that there is adequate water, sewer capacity and other necessary utilities for developments. Preservation of wetlands and natural habitats of endangered plant and animal species is controlled by federal laws, in addition to local zoning laws. In urban areas, zoning laws will prescribe, for each specified zoning district, the uses to which real estate can be put (industrial, commercial, residential or institutional), the density of development (number of square feet of building space per unit of land area), the height, setback and overall architectural configuration of individual buildings, the sizes and configurations of yards and open space, and street frontages. Zoning laws often contain incentives or requirements for developers to provide public goods, such as affordable housing, parks and other public amenities, in connection with a new development. Many localities also require preservation of designated landmark buildings. Legal challenges to land use regulations continue to be brought in state and federal courts, which set the limits of how far government can go in regulating the uses to which land can be put without constituting an unconstitutional 'taking' of the private property of the landowner.

ii Environment

Liability of a landowner for contamination of land and water by hazardous substances is governed by both federal and state laws, and enforced concurrently by federal and state governments. The primary federal laws governing hazardous substances liability are the Comprehensive Environmental Response, Compensation and Liability Act and Resource Conservation and Recovery Act. Both of these statutes make the owner and the operator of land financially and legally responsible for hazardous substance contamination of land that they own or operate, as well as any contamination of neighbouring land or water caused by activities on the land they own or operate. Nearly every state has adopted environmental statutes requiring owners and operators to prepare specific plans for approval by the state environmental agencies for remediation of soil and water contamination caused by hazardous substances. Some states require an approved remediation plan to be in place before an owner can transfer title to any property that was used for industrial use. As part of the due diligence investigation for a property acquisition, a buyer will conduct a Phase I environmental study to determine the past uses of the land, and whether any federal or state environmental violations have been noted. If the Phase I study indicates possible environmental liability, a Phase II study, in which soil and groundwater samples are studied, is customarily undertaken prior to property acquisition. A new buyer of property will become liable for cleanup obligations, even if they have occurred in the past, although the new owner will have the right to claim against the prior owner or operator that caused the contamination.

iii Tax

Many state and local jurisdictions, including towns or counties, impose a transfer tax on transfers of real estate. The amount of tax generally ranges from a few tenths of a percentage point up to more than 3 per cent of the consideration paid for the transfer. Nearly all jurisdictions that impose a transfer tax will tax transfers of fee title. Others will also tax long-term ground leases, transfers of majority interests in entities that own real estate and transfers of other title interests, including easements, lease assignments and air rights. Some jurisdictions will also tax mortgages based on a percentage of the principal amount. These taxes are paid at the time of transfer and recording of the transfer instrument, and are usually (but not always) imposed on the transferor.

iv Finance and security

The most common forms of security for a real estate loan are a mortgage (which creates a security interest for the lender in the real estate) and a mezzanine pledge (which creates a security interest for a lender in the ownership interests in the entity that owns the real estate). A first-priority mortgage is given to the most senior lender, typically with a loan that does not exceed 50 to 75 per cent of the value of the property. If larger amounts are borrowed, the additional loan will be junior in priority to the mortgage loan, and will be secured by a pledge of the ownership interests in the entity that owns the real estate, and not the real estate itself. Thus, when a first mortgage lender forecloses on a mortgage collateral to enforce its loan, it will ultimately hold a sale of title to the property itself to receive repayment on its loan, and will wipe out all junior liens, including a mezzanine pledge, in the event that the sale proceeds are not sufficient to pay off claims. When the mezzanine lender forecloses on its security interest in the ownership entity, it will take title to the ownership interests of the property subject to the mortgage, and the mortgage will remain intact. Both mortgages and security pledges are subject to and enforced under state laws. While details of the enforcement process vary from state to state, lien priority issues are generally similar. In CMBS, where mortgage loans are pooled into a single trust and securities of differing priorities created in the trust, the enforcement of the underlying mortgages follows the same state law process as for single loans.

VI LEASES OF BUSINESS PREMISES

Most occupancy by businesses of retail and office space is done through leasing rather than ownership by the business of the space it occupies. The leasing arrangement allows businesses to have maximum flexibility to expand and acquire more space or relocate geographically as needed, and not to tie up scarce capital in real estate.

i Office leases

Typical provisions of office leases are as follows:

Term and renewals

Terms are usually 10 to 15 years, often with options to renew for one or two additional five-year periods.

Base rents and operating expenses

Base rents are either fully net, where the tenant pays a base rent plus its *pro rata* share of all operating expenses and real estate taxes attributable to the property, or pays a base rent plus its *pro rata* share of increases in operating expenses and real estate taxes over a stipulated base amount. Base rents will increase on an annual basis, or will increase cumulatively over a five-year period, at a stipulated amount sized to keep pace with anticipated inflation.

Tenant improvements

An office landlord will pay for initial improvements to the office space, or provide an allowance to the tenant to pay for improvements, and will provide a rent-free period at the beginning of the lease to enable a tenant to complete the work and move in. The cost of these concessions is factored into the rent.

Assignment and subletting

Tenants may be permitted to sublet with landlord approval, with criteria as to creditworthiness of the successor and non-competition with the landlord's leasing of the building. The tenant will usually be required to give or share any sublease profits with the landlord. Tenants are not relieved from lease liability by assigning or subletting, but remain jointly and severally liable with the subtenant.

Building services

Tenants will often be required to purchase building services, such as electricity, cleaning, air conditioning and building management, through the landlord.

Default and termination

If a tenant defaults in lease performance, a landlord may terminate the lease and evict the tenant by court order from possession of the premises. Even after a lease is terminated and the tenant evicted, the tenant will remain liable for damages equal to the rent under the lease until the landlord finds a replacement tenant (and will thereafter remain liable to pay any shortfall between the lease rent and the new rent).

ii Retail leases

Retail leases differ from office leases in the following respects:

Base rent

Base rent is usually fully triple-net, and tenants are responsible to pay a *pro rata* share of property operating expenses and real estate taxes from dollar one, rather than over a stipulated base amount.

Percentage rent

Retail rents commonly include percentage rents, in which tenants pay, in addition to base rent and operating expenses and taxes, a percentage of their adjusted gross sales proceeds over a breakpoint. This enables a landlord to offer a lower going-in base rent, and to share in the upside if sales are robust.

Common area maintenance charges

In shopping malls and other retail centres where there are large common areas, and tenants benefit from common marketing and promotional activities, there is also a common area maintenance charge paid *pro rata* by tenants.

Use clauses and continuous operation covenants

Retail leases, particularly in shopping centres, generally contain strict use clauses identifying the image, branding and products to be carried by the retailer, as well as minimum and maximum hours of operation and a covenant to operate without interruption. Both landlord and tenant will expect radius restrictions on competing operations – the tenant will be restricted from having another identical brand store within a specified radius of the shopping centre, and the landlord will be restricted from having competing brands within the shopping centre, to help ensure the success of the retail operations.

VII DEVELOPMENTS IN PRACTICE

Following are some of the major recent developments in US real property law and practice.

i CMBS loan originations and securitisation

In response to the default and workout experiences over the past four years, there is ongoing rethinking of all aspects of lending practices in the CMBS market. On the loan underwriting side, improved protections of CMBS 2.0 include higher debt-service coverage ratios, lower loan-to-value ratios, and more conservative cap rate analysis and property valuations. On the securitisation side, protections include higher credit enhancement requirements, deeper junior tranches to support super-senior tranches and enhanced regulatory requirements, including the 5 per cent issuer risk retention described above. On the legal or structural side, protections include the use of an operating adviser to represent the interests of all bondholders while a loan is in special servicing, transfer of the controlling class rights based on appraisal rather than realised reductions in portfolio value to better align decision-making with the first-loss position, and a move towards uniform representations and warranties.[9] There has also been increasing focus on conflicts of interests between special servicers on CMBS portfolios and the bondholders whom they represent, while CMBS loans continue to be worked out.

ii Bankruptcies

The trend in mortgage financing during the lending boom earlier in the decade was to establish single-purpose entity (SPE) borrowers that owned only the mortgaged asset and would not be consolidated with other entities in the event of an insolvency. In the case of a loan default, the borrower entities were discouraged from filing for bankruptcy through use of springing recourse guaranties and various SPE provisions, including

9 Source: Fitch Ratings, *Structured Finance*, 'CMBS 1.0… 2.0… 3.0 …But Are We Progressing?', 4 January 2012.

independent directors. Despite these anti-bankruptcy provisions, a number of multi-asset real estate companies have over the past few years sought bankruptcy reorganisation for the company as a whole, and filed their SPE asset-holding borrowers in bankruptcy as well. Some notable legal principles to emerge from recent high-profile real estate bankruptcies are that:

a SPE borrowers that are part of an integrated operating group of companies may consider the interests of the entire group in determining to file for bankruptcy, and need not themselves be insolvent at the time of filing;[10] and

b it does not constitute bad faith for an SPE entity to replace its independent directors installed for the purpose of discouraging a filing, and replacing them with new directors willing to file if in the best interests of the operating group.[11]

iii Enforcement of non-recourse carve-out guaranties

One of the most effective means for lenders to prevent a borrower from filing for bankruptcy is to require a principal of the borrower to give a 'bankruptcy springing recourse guaranty' as part of the loan, under which the guarantor assumes full personal liability for the entire amount of an otherwise non-recourse debt if the borrower voluntarily files for bankruptcy, or colludes in an involuntary bankruptcy filing. In several decisions across the US in the last year, courts have upheld the validity of bankruptcy springing recourse guaranties against the guarantors, holding that they:

a are not void as *ipso facto* clauses under the bankruptcy code, but are rather a legitimate and permissible mode of bankruptcy-remote structuring;[12]

b are not void as *in terrorem* clauses, but create an important deterrent effect to the behaviour sanctioned;

c do not constitute a penalty, or unenforceable liquidated damages, but represent an agreement to pay a valid debt of a sum certain;[13]

d do not induce breach of fiduciary duty or set up a conflict of interest for directors, whose duties are to the company and its shareholders and creditors, and not to the guarantor;[14] and

10 *In re General Growth Properties, Inc., et al.* (Bankr. S.D.N.Y., Case No. 09-11977).

11 Ibid.

12 See *First Nationwide Bank v. Brookhaven Realty Assoc.*, 223 A.D. 2d 618 (NY App. Div. 2d Dept. 1996), finding that a bankruptcy full recourse guaranty was enforceable as written, even if no damages as result thereof; *Bank of America, NA v. Lightstone Holdings LLC and Lichtenstein*, No. 09-01353 (SDNY 2009), finding that it is legitimate to carry out bankruptcy-remote structuring.

13 See *CSFB 2001-CP-4 Princeton Park Corporate Center LLC v. SB Rental I LLC*, 410 N.J. Super. 114 (NJ Super. 2009), upholding full guarantor recourse (in a non-bankruptcy carve-out situation) on the grounds that repayment of debt is actual damages, not liquidated damages, and carve-outs just set terms of liability rather than setting measure of damages.

14 See *UBS v. Garrison Special Opportunities Fund* (Sup. Ct. NY County, Index No. 652412/2010), finding that there is 'no distinction between this set of facts and those involving any parent

e are not void on public policy grounds favouring bankruptcy, because the real estate financial markets, consisting of powerful and sophisticated business interests, created another paradigm for dealing with lending risk and remedies that was designed to avoid bankruptcy courts.[15]

iv Mezzanine lender enforcement of remedies and intercreditor agreements

Mezzanine loans, which are structurally junior debt to first mortgage loans and have as collateral a pledge of the ownership interests in the entity that owns real estate, are governed in part by intercreditor agreements with mortgage lenders entered into at the time of the financing of the property. Under a typical intercreditor agreement, a mezzanine lender is permitted to foreclose its collateral in the event of a mezzanine loan default, and following foreclosure to 'step into the shoes' of the borrower under the mortgage loan, without triggering a mortgage default. Once the mezzanine lender takes over the interests in the borrower entity, the mezzanine lender becomes liable to cure any defaults that were outstanding under the mortgage loan as of the foreclosure, to the extent susceptible of cure by the mezzanine lender. In at least two important recent decisions, state courts in New York and Arizona have refused to let mezzanine lenders foreclose their collateral unless all pre-existing mortgage defaults were cured prior to the mezzanine foreclosure, rather than following.[16] The effect of these decisions is to place significant obstacles in the path of the mezzanine lender attempting to foreclose its collateral, and to give the first mortgage lender significant leverage in workout negotiations.

v Distressed debt acquisition as an investment opportunity

Investors looking to acquire real estate assets at a bargain price have increasingly turned to purchases of distressed debt as a means to accomplish this. Bank lenders who hold distressed debt often find it advantageous for regulatory purposes to sell distressed debt at a discount rather than to retain the debt and reserve against it. Borrowers likewise have sometimes found new owners of the debt more able and willing to renegotiate a workout, since the new owners, having acquired the debt at a discount, are in a position to profit from a workout. Buyers of distressed debt must do substantial due diligence about the underlying real property asset and its value, the structural position of the debt

corporate guaranty of a debt of a subsidiary', and that such guaranties are a 'common commercial arrangement not subject to question'.

15 See *FDIC v. Prince George Corp*, 58 F.3d 1041 (4th Cir. 1995), finding that a carve-out guaranty did not prevent a borrower from filing, but the guarantor would merely forfeit its exemption from liability for any deficiency.

16 *Bank of America, NA v. PSW NYC LLC*, 918 N.Y.S.2d 396 (2010) (enjoining the mezzanine lender from foreclosing on its equity interest in the mortgage borrower until after such lender cured all defaults under the senior loan, which included paying the accelerated balance of the loan totalling near US$3 billion); *US Bank Nat'l Assoc v. RFC CDO 2006-1, Ltd*, Case No. 4:11-cv-664, Doc. No. 41 (D. Ariz. 6 December 2011) (enjoining the mezzanine lender from foreclosing on its equity interest in the mortgage borrower after the mezzanine lender failed to cure all defaults under the senior loan).

(mortgage or mezzanine, or CMBS security), the type of security for the debt and any perfection problems in the security. Purchasers must also be knowledgeable about legal issues in debt enforcement that will affect the dynamics of the workout negotiations among the lender, any senior or junior lenders, and the borrower, such as the mezzanine foreclosure issues described above.

vi Land use planning and climate change: recovery from Hurricane Sandy

Hurricane Sandy, which struck New York City and surrounding areas with lethal force in September 2012, has led to a major rethinking about land use patterns, waterfront development, and building design and codes in New York City and much of the northeast region. Previously, New York City had not seen major damage from environmental disasters prompted by global climate change, and the Manhattan, Brooklyn and New Jersey waterfronts were among the most active markets for new residential development. With much of New York City's energy and transportation infrastructure temporarily disabled by the hurricane, and thousands of residential units around the region and millions of square feet of lower Manhattan office space rendered unoccupiable for more than 60 days after the hurricane, new technologies to prevent long-term damage to both public and building infrastructure from increasingly severe storm patterns are being developed, and zoning and code changes are currently under consideration. On the building level, these include installation of back-up generators and floodgates, raising the location of building equipment, and creating flood reservoirs in basements. On the citywide level, these include redrawing flood zones, which will affect insurance costs and availability, re-tooling and waterproofing the electrical and communications grids, and rethinking waterfront zoning and development patterns.

VIII OUTLOOK AND CONCLUSIONS

The prospects for 2014 transactions differ widely across the local markets. The core central business districts – New York City, Boston, San Francisco and Washington, DC – have rebounded in values and transaction volume much more strongly than other areas of the country, and are expected to remain strong in 2014. Residential markets in these core areas, both multifamily rentals and condominiums, have increased considerably in transaction volumes and prices. New development of office and residential product in these cities attracts foreign investment capital as well as foreign buyers. Existing core properties attract major institutional investors.

In other regions of the United States, and in suburban areas outside of the core central business districts, office vacancies remain relatively high, and rents and values generally remain little improved since 2008. The US housing market overall stabilised tremendously during 2013, as the overhang of foreclosed properties that depressed prices and sales volumes has begun to ease through the lessening of volume of new foreclosures and increasing acquisitions by private equity funds of large quantities of single-family homes for rental occupancy. Although interest rates remain at historic lows, mortgage underwriting standards have increased such that the total volume of new loans and refinancings remains below expectations.

The overall outlook for 2014 is increased equity investment in core office and multi-family assets in core markets by both domestic and foreign investors. The pace and value of growth and new real estate development, however, is directly dependent on improvements in the overall US and global economies. The US outlook is also highly dependent on federal government fiscal and regulatory policy, including the resolution of the budget and tax policy debates in the US Congress.

Appendix 1

ABOUT THE AUTHORS

PARASKEVI A ANARGYROU

Dryllerakis & Associates

Paraskevi A Anargyrou is active in the fields of commercial law and trademarks, and specialises in real estate law (due diligence of real estate, public tenders regarding lease or transfer of state-owned real property, sale and leaseback agreements, construction agreements, etc.) and tax law (VAT, withholding tax, stamp tax, capital concentration tax, consumption tax, import duties, third-party taxes, the Books and Data Code).

Ms Anargyrou is a graduate of the Athens University Law School and has been a member of the Athens Bar since 1974. She is qualified to practise before all courts at all levels of jurisdiction. She speaks Greek and English.

FILIPA ARANTES PEDROSO

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Filipa Arantes Pedroso joined the firm in 1979 and became a partner in 1987. She is head of the corporate and real estate practice group.

She is very active in mergers and acquisitions and company law, having acted for relevant national and international clients. She has also been very active in the project finance area.

In the area of real estate, Ms Arantes Pedroso has been responsible for the firm's major projects concerning the structuring of real estate transactions, tourism projects and incorporation of real estate management companies and real estate funds.

She is the author of several articles in national and international specialist magazines.

DIEGO ARMERO

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Diego Armero is a partner in the Madrid office of Uría Menéndez. He joined the firm in 1999 and became a partner in 2006. Mr Armero advises on all types of real estate transactions and, particularly, on the sale and purchase of companies operating in the real estate sector, asset deals, sale and leaseback transactions, loan portfolios and real estate finance.

BARLAS BALCIOĞLU

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Barlas Balcıoğlu's real estate experience includes advising on direct and indirect provision of equity to investment and development projects. His clients include owners, developers, investors and others in connection with the development, purchase, sale and exchange of commercial real estate such as business complexes, shopping centres, hotels and vacant land for development purposes. He has substantial experience representing owners in construction matters, including the structuring of complex design-build projects and construction management arrangements.

He also specialises in structured finance transactions, in particular project finance, real estate finance and restructurings. His clients include commercial and investment banks, borrowers, institutional investors and project sponsors.

Mr Balcıoğlu's corporate experience includes mergers and acquisitions (M&A) as well as domestic and international joint ventures. In the course of his Frankfurt practice, he was involved in bank M&A deals, and supervised and coordinated the regulatory filings of German clients in Turkey.

He is a graduate of Istanbul University Faculty of Law (LLB, 1998) and Sheffield University Law School (LLM, 1999). He is the co-founder of the Istanbul based law firm, Balcıoğlu Selçuk Akman Keki. He is a member of the Istanbul Bar, and is fluent in English, German and Dutch.

ALESSANDRO BALP

Bonelli Erede Pappalardo

Alessandro Balp is a partner in the Milan office of Bonelli Erede Pappalardo and coordinates the firm's real estate practice.

Mr Balp is routinely involved in many of the largest and most complex transactions in the Italian market. His clients in the real estate sector include major property companies, Italian and foreign real estate institutional investors, real estate funds, asset management companies and insurance companies.

He joined Bonelli Erede Pappalardo in 2001 and became a partner in 2005. From 1999 to 2000, he worked as an associate for Simpson Thacher & Bartlett LLP in New York. Mr Balp graduated with honours from the University of Milan in 1994 and obtained his LLM degree at the Yale Law School in 1999. He was admitted to the Italian Bar in 1998 and has also been admitted to the New York Bar.

ANDREW BEMBRIDGE

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Andrew Bembridge is a director at ENSafrica in the real estate and property department.

He has acted for a number of notable mining companies, banks and property development companies.

His practice experience entails his involvement in many major property transactions throughout South Africa and Africa. His experience encompasses developments such as township proclamations, land use applications, water projects, and environmental and heritage applications. His experience further extends to extensive commercial property transactions, involving immoveable and moveable property, the drafting of intricate agreements and the implementation of the transactions arising out of those agreements.

He also has extensive experience in the land rights and restitution laws of South Africa, assisting both land owners and communities, and has served as a member of the Johannesburg Attorneys Association Property Law Committee.

He jointly leads the firm's real estate and property department with Allison Alexander and Len Vorster.

He is recognised as a leading lawyer by the following reputable rating agencies and their publications: *Best Lawyers 2013* – Real Estate (South Africa) and *PLC Which Lawyer? 2012* – Corporate Real Estate (South Africa).

He has a BComm (University of KwaZulu-Natal), LLB (University of Cape Town) and an HDip Tax (University of the Witwatersrand).

He is admitted as an attorney, conveyancer and notary public of the High Court of South Africa.

PÉTER BERETHALMI

Nagy és Trócsányi Ügyvédi Iroda

Péter Berethalmi is the managing partner of Nagy és Trócsányi. In addition to his position as managing partner, Dr Berethalmi is a partner in the firm dealing with mergers and acquisitions, property transactions and project finance matters. His clients include foreign multinational corporations and financial institutions. Dr Berethalmi joined the firm in 1996; he has been a partner since 2001 and became managing partner in 2005. He speaks Hungarian and English.

CÉCILE BERGER MEYER

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Cécile Berger Meyer is head of real estate at Lenz & Staehelin in Geneva, where she has been a partner since 2013. She regularly advises both private and institutional clients in the field in respect of both civil matters (purchases, sales, structuring and financing) and administrative law matters (planning, construction licences, restrictions on acquisitions).

Ms Berger Meyer attended the University of Fribourg (lic iur), gained an LLM from the University of Chicago Law School, and in 2010 undertook a certified specialist SBA in construction and real estate law qualifying her as a certified SBA real estate and construction law specialist. She is admitted to the Geneva Bar and sits as landlord judge in the Geneva lease court.

JOE CARROLL

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Joe Carroll is a specialist real estate lawyer based in the Dubai office of Dentons. He joined the firm in 2011, having previously worked for an international property development company headquartered in Dubai. Prior to relocating to the UAE in 2008, he trained in London at an international law firm and qualified into their real estate team. With several years' experience on the ground, working in house and private practice, Mr Carroll has an in-depth understanding of real estate law and practice in the UAE. He has advised on a wide range of real estate transactions, including sales and acquisitions, real estate finance, industrial, commercial, residential, mixed-use and hotel and leisure developments, and landlord and tenant matters.

LYNDA CHINWEOKWU

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Lynda Chinweokwu is an associate at G Elias & Co. She holds an LLB (University of Lagos). A member of the Nigerian Bar, her main practice areas are banking and real estate.

YVES DELACROIX

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Yves Delacroix ranks among the leading real estate lawyers in Belgium. He has extensive experience in handling large real estate transactions, and has particular expertise in sale, sale and leaseback, and lease (and other occupational or financial contracts, such as long-term leases, building rights, usufruct, financial or VAT leasing), and in related commercial contracts and construction law issues. Mr Delacroix acts for investors, developers, corporate users and retailers. He handles both real estate asset and corporate real estate transactions.

He is the author of several publications and teaches real estate law at the University of Louvain (executive master of real estate programme at the Louvain School of Management).

Mr Delacroix joined Liedekerke Wolters Waelbroeck Kirkpatrick in 1990, where he became a partner in 2000. He has a law degree from the Université Catholique de Louvain (1986), a degree in international law from the University of Leiden in the Netherlands (1987) and a degree in business administration from the Louvain School of Management (1988).

AGATA DEMUTH

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Agata Demuth is a partner in Schönherr's Warsaw office. She focuses on real estate law, including without limitation real estate purchase, sale and use transactions, as well as conducting investment projects. She has extensive experience in structuring and negotiating real estate purchase and sale transactions, as well as implementing and financing investment projects, including investment agreements concerning real estate projects. She also negotiates real estate tenancy, lease and leasing agreements, and advises on setting out real estate management terms. She is an expert in the restructuring of international groups acting on the real estate market, and in mergers and acquisitions on that market. Ms Demuth has many years' experience in working for Polish and international commercial and residential developers, investors from the hotel sector and entities from the financial services sector.

MIROSLAV DUDEK

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Miroslav Dudek is an attorney-at-law at Schönherr's Prague office, where he specialises in all aspects of real estate law. He has experience in advising transnational companies in the acquisition of real estate in the Czech Republic, as well as in constructing and operating commercial and retail centres.

Mr Dudek studied law at Charles University in Prague and at the Technical University in Dresden, Germany. He is a member of the Czech Bar Association. He advises international clients on their market entry in the Czech Republic. He is part of the team providing full-service transaction support in the realisation of transnational deals in the real estate sector. Mr Dudek provides assistance to various clients on real estate matters, including all-round consultancy in lease matters. He is fluent in Czech, German and English.

GBOLAHAN ELIAS

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Professor Gbolahan Elias is a partner at G Elias & Co. He is also a visiting professor of law at Babcock University Ilishan. Called to the Nigerian and New York Bars, he is a member of the Chartered Institute of Arbitrators and a Senior Advocate of Nigeria.

IBRAHIM ELSADIG

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Ibrahim Elsadig is a senior partner in the Dubai office of Dentons. He joined the Dubai office of the firm in March 1996 as a corporate and commercial lawyer. He worked as an in-house counsel in Africa, India and the Middle East between August 2005 and December 2006, after which he rejoined the firm. He has extensive experience in the UAE and Middle East, and has participated in major transactions in the UAE and across the Gulf region, North Africa and India. Mr Elsadig's experience includes joint ventures, mergers and acquisitions, liquidations, bankruptcy and restructuring. He has reviewed major agreements for compliance and legal due diligence, and has also advised on major projects in the water, waste water, electricity and oil and gas sectors, and has an excellent banking background. He has worked on power generation, EPC contracts for power plants, long-term service agreements, and operation and maintenance agreements. He also advises on corporate governance and compliance issues. He now supervises a broad range of corporate and commercial matters, including real property.

PATRICK FORSLUND

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Patrick Forslund is a partner in and head of the real estate group of Advokatfirman Vinge KB. He graduated from the University of Stockholm in 1994 (LLM/BA). After serving at the district court in Handen outside Stockholm (1995 to 1996), he joined Vinge in 1996 and became a partner in 2005. In 2000, he spent a year on secondment in the corporate department of Allen & Overy in London.

Mr Forslund has extensive experience of the real estate sector and advises on all aspects of real estate law, with a particular focus on real estate M&A. His clients primarily include Swedish and international property companies, investment funds and financial institutions.

He is consistently ranked as a leading real estate lawyer in domestic and international surveys, and is ranked as a leading real estate lawyer in *Chambers Europe*

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PIERRE GEBAROWSKI

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Pierre Gebarowski specialises in real estate acquisitions and financings, banking law, and construction and urban development law. His practice also includes litigation in these areas.

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ALİ CAN GÖREN

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Ali Can Gören concentrates on banking and finance, real estate, privatisations, and regulatory and public law matters. He assists multinational and Turkish companies in the real estate and energy sectors in corporate loans, general corporate matters, company establishments, due diligence investigations and drafting of agreements and memoranda. Mr Gören is a graduate of Bilgi University Faculty of Law (LLB, 2012). He is a member of the Istanbul Bar, and he is fluent in English and French.

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Michał Gruca is a senior associate with Schönherr in Warsaw with more than five years of experience as a qualified lawyer. He mainly focuses on real estate, IP and litigation-related work in Poland, and is involved in most of the litigation that Schoenherr Warsaw handles. He acts frequently for clients in the automotive industry, food and non-food wholesale, the fragrance industry and the aluminium industry, advising them in terms of day-to-day commercial business and litigious proceedings. He has also recently advised BBC World News regarding cooperation with Polish clients, and advises Polish Television on compliance with the press law and protection of personal rights. Mr Gruca holds degrees from the University of Szczecin (*Magister iuris*). He is admitted to the Bar in Poland, and has published a number of articles on the civil, real estate, litigation and compliance, and white-collar criminal law in Poland.

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Michael Henderson has over 20 years' experience and is qualified in Scotland, and England and Wales. His areas of experience include property investment and development, development funding, joint ventures, landlord and tenant, portfolio acquisitions and primary care developments. His clients span private and public sector organisations located in the UK and abroad. Mr Henderson is one of the few Scottish solicitors listed in the real estate section of *The International Who's Who of Business Lawyers*.

VÉRONIQUE HOFFELD

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Véronique Hoffeld, partner, heads the commercial and litigation department of the Luxembourg office of Loyens & Loeff.

Her activities cover commercial law (negotiation of contracts), litigation and arbitration, real estate law and environment law. She advises on all aspects of real estate law, including transactional work. She conducts due diligence investigations in the real estate sector and negotiates real estate contracts. She also has significant experience in handling real estate litigation for both claimants and defendants. Prior to joining Loyens & Loeff, she worked for more than 10 years in another major Luxembourg law firm, where she was made partner in 2003.

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KEVIN HOY

Mason Hayes & Curran

Kevin Hoy is head of real estate and a former head of financial services in the firm. His recent work includes acting in the sale and purchase of distressed assets, acting in the acquisition of privatised assets and advising debt providers in the financing of residential and commercial real estate portfolios. He has acted in renewable energy projects since the mid-1990s. His focus is on real estate security and financing as well as restructuring and workouts.

EDWARD HSU

Dentons

Edward Hsu is a counsel in the Shanghai office of Dentons. His practice encompasses a broad range of commercial transactions, with an emphasis on real estate-related acquisition, development and finance, as well as structured trade and commodities finance. He is also a key member of Dentons' hotels and leisure practice in the Greater China region, and has advised owners, developers and managers with respect to a variety of high-end hotel, private club and serviced residential condominium projects in China. Mr Hsu has written for *The Real Estate Finance Journal* and *Practical China: Tax and Finance Strategies* (Thomson Reuters) on private equity and other matters in China.

SOPHEALEAK ING

Bun & Associates

Sophealeak Ing is the firm's practice leader of the real estate, commercial contracts and intellectual property practices. His recent work includes securing the acquisition of multi million-dollar properties for foreign-based clients, as well as securing long-term lease agreements on behalf of a number of multinational companies for their multi-million dollar investments within the Phnom Penh Special Economic Zone. He has also assisted foreign investors on a number of economic land concessions, particularly in the area of palm oil and rubber plantations. He provides advice on land holding structures and related issues and distributorship, as well as business licensing. He previously counselled a leading engineering firm, with regional presence, on major onshore and offshore construction projects, assisted Cambodia's largest premium rice exporter in securing a multi million-dollar equity participation from a foreign investment fund, and facilitated the acquisition of prominent businesses in the food and beverage sector. Mr Ing also previously counselled an international petroleum company on its intellectual property infringement matters. He is described in *Chambers & Partners' Asia Pacific 2013* by his clients as 'fast-thinking and very responsive, and gives clear and precise explanations'. He is fluent in Khmer, English and French.

TOMOHIRO KANDORI

Nishimura & Asahi

Tomohiro Kandori is an associate whose practice focuses mainly on real estate finance and ship finance. He has advised on numerous transactions as counsel for lenders, arrangers, trustees, general contractors, real estate developers, equity investors and sponsors. He has also worked as an in-house counsel at a Japanese bank in London. He was admitted to practice in Japan in 2002.

MEREDITH J KANE

Paul, Weiss, Rifkind, Wharton & Garrison LLP

A partner in the real estate department at Paul, Weiss, Rifkind, Wharton & Garrison LLP and a member of the firm's management committee, Meredith Kane's experience includes all aspects of development, finance, acquisitions and sales, equity joint ventures, restructuring, leasing and securitisation of real estate. Ms Kane has represented a long list of public entities and private companies in major real estate transactions in New York

Ms Kane was Commissioner of the New York City Landmarks Preservation Commission from 1995 to 2004. She currently serves on the boards of the Lower Manhattan Cultural Council, the Forum for Urban Design, the New York Foundation for Senior Citizens, the Association to Benefit Children, the Olana Partnership and the Avenue of the Americas Association (which she chaired from 1999 to 2007). She is a member of the Real Estate Board of New York, WX-Women Executives in Real Estate, the New York Women's Forum, the Urban Land Institute and the Association of the Bar of the City of New York (former chair, Economic Development Subcommittee, Land Use Planning and Zoning Committee). She has served as co-chair of the New York State Bar Association's Advanced Real Estate Practice annual conference.

Ms Kane was honoured as the 2012 'Best in Real Estate' at the Euromoney Legal Media's inaugural Americas Women in Business Law Awards, 2009 Woman of the Year by WX – New York Women Executives in Real Estate, and was named one of the top 50 women in real estate and one of 25 current leaders in the industry by *Real Estate Weekly* and the Association of Real Estate Women. *Grid Magazine* named her one of the top 10 American women in real estate development. She is cited as one of the leading real estate lawyers in the United States in *Chambers USA*, *Who's Who Legal USA*, the *Legal 500*, *The Best Lawyers in America* and numerous other peer-reviewed publications. She is a member of the prestigious American College of Real Estate Lawyers.

NAOKO KATAKAMI

Nishimura & Asahi

Naoko Katakami is an associate with expertise in asset management and real estate investment trusts, including listed J-REITs. She also specialises in capital market transactions, loan securitisations and financial regulations with respect to financial institutions. She has also worked as a foreign attorney at a leading law firm in Australia. She was admitted to practice in Japan in 2005 and in New York in 2013.

INGO KLÖCKER

Hengeler Mueller

Ingo Klöcker received a doctoral degree from the University of Freiburg and an MCJ from the University of Texas at Austin School of Law. He joined Hengeler Mueller in 1984 and became a partner in 1988. Dr Klöcker specialises in M&A-related work, both corporate and real estate. He has been advising on large portfolio transactions involving office, hotel and other commercial properties, as well as residential, on both the sale and the purchase sides, various airport privatisations, industrial settlements, and the sale and purchase of major enterprises. He also has experience in acquisition finance.

Dr Klöcker is also a notary with a focus on real estate transactions and corporate work. He speaks German and English.

MARTIN KUBÁNEK

Schönherr Attorneys at Law

Martin Kubánek is the managing partner of Schönherr in Prague. He specialises, in particular, in corporate/M&A, real estate law and corporate restructurings, and frequently acts for international clients investing in the Czech Republic as well as on outbound investments of Czech companies.

Mr Kubánek studied law at Charles University in Prague, and was admitted to the Czech Bar Association in 1991. Prior to joining Schönherr, he was a partner in the Prague office of Gleiss Lutz, of which he was a co-founder (1993 to 2008). He was seconded to Patterson Belknap law firm in New York (1994) and Macfarlanes in London (1992).

He has broad experience in advising in real estate development, covering all areas from securing, buying and developing of property rights up to the stage of completion of the building project and its subsequent sale or lease. He has also been involved in numerous foreign investments into the Czech Republic in the real estate, media, insurance, heavy industry and telecoms sectors. His clients include logistic companies, real estate investment funds and retailers. Mr Kubánek is fluent in Czech, English and German.

KOZO KUROMATSU

Nishimura & Asahi

Kozo Kuromatsu is an associate with an expertise in tax planning, tax investigation and tax litigation. He was admitted to practice in Japan in 2010.

VLADISLAV KYSIL

KPD Consulting Law Firm

Mr Vladislav Kysil holds a degree in law with honours from the National University 'Yaroslav the Wise Law Academy of Ukraine' (2002) and a degree in banking from the School of Economics of VN Karazin Kharkiv National University. He is an attorney admitted to the Kiev City Bar Association (since 2006). Mr Vladislav Kysil is a partner at the firm and his main area of practice is real estate transactions in Ukraine, for which he provides a full range of legal expertise encompassing all aspects of acquisitions, development, leasing, construction, finance and dispute resolution, with a particular emphasis on secured lending and project financing.

Before joining KPD Consulting Law Firm, Mr Kysil practised in the Kiev office of international law firm Salans. Previously, Mr Kysil worked as an in-house legal adviser for HVB Bank Ukraine (Unicredit Group). His experience includes an internship period with Bank Austria.

Since 2006, Mr Kysil has been a visiting professor at the National Training Centre of the National Bank of Ukraine. A recognised expert in real estate law, he has been the elected Chair of the Legal Committee for the Ukrainian Real Estate Club (www.ureclub.com) since 2010.

LEIF LAITINEN

Krogerus Attorneys Ltd

Leif Laitinen's practice focuses on corporate, real estate and capital market transactions. Mr Laitinen has advised clients in several real estate transactions and related financing and structuring matters, acting for both sellers and purchasers. He has represented Finnish and international private equity funds, major construction companies and property developers as well as institutional investors.

EUN NYUNG LEE

Shin & Kim

Mr Eun Nyung Lee is a partner at Shin & Kim. His practice primarily focuses on corporate and financial transactions, particularly mergers and acquisitions (M&A), real estate and international arbitration. He has significant experience in cross-border M&A, domestic M&A, real estate, private equity, acquisition financing and real estate financing. He worked as an international lawyer in the Hong Kong office of Cleary Gottlieb Steen & Hamilton, and was involved in capital market transactions such as IPO and debt offering.

KYUNG DON LEE

Shin & Kim

Kyung Don Lee is a partner and co-head of the real estate and real estate finance practice group. He is one of the leading experts in the field of real estate law in Korea and has been involved in many of the largest real estate transactions in Korea. He also specialises in construction and development and project financing in connection with real estate transactions. Mr Lee graduated from Seoul National University with a BA and completed his LLM at Columbia University School of Law. He has worked at Shin & Kim, and Winthrop, Stimson, Putnam & Roberts in New York. He has represented many REFs in the acquisition, financing, operation and disposition of real estate assets, as well as financial institutions and project financing funds in connection with loans to various real estate investors, including developers.

EDDY MAREK LEKS

Leks & Co

Eddy Leks is the founder and managing partner of Leks & Co, a multi-services law firm filled with young, energetic, creative lawyers providing high-quality legal services and quality management, and delivering services based on definite core values. With a legal career in mind, he started his experience in the practice areas of general corporate-commercial and general litigation. Afterwards, he joined Hadiputranto, Hadinoto & Partners (HHP), an affiliated law office of Baker & McKenzie. There he worked in the practice areas of capital markets, general corporate-commercial, taxation, foreign investment and customs. He left HHP to join PT Lippo Karawaci Tbk, one of the biggest property and real estate development and investment companies in Indonesia, where he rose to become a legal senior manager. His main responsibilities were managing the company's general corporate-commercial issues, build-operate-transfer projects, and acquisition of shares and assets for property projects. He was one of the company's youngest legal managers when he joined.

Mr Leks specialises in real estate law. His writings have been published in many prominent publications locally and internationally, such as *Forbes Indonesia*, *Property&Bank*, *Kontan*, *LAWASIA Journal*, the International Bar Association *Real Estate Newsletter* and *Jurnal Hukum Bisnis*. He is also invited to speak at many events, locally and internationally, on real estate law and other law matters. Mr Leks and his firm Leks & Co are recommended by *Legal 500*, *Asialaw Profiles* and *Chambers and Partners* in the field of real estate in Indonesia.

DORIS LIN

Lee and Li, Attorneys-at-Law

Doris Lin, an associate partner at Lee and Li, Attorneys-at-Law and a member of the Taipei Bar Association, focuses her practice on real estate transactions, cross-border investments, mergers and acquisitions, antitrust law, international trade law, labour law, insurance and securities laws. Ms Lin has more than 10 years of experience in these fields, and has assisted both local and foreign clients in the purchase of real estate, cross-border investments, mergers and acquisitions, and international trade investigations. She has also been counsel to the Chinese National Federation of Industries for many years.

GEORGE LOUTAS

Maples and Calder

George Loutas is head of the property and construction group in the Cayman Islands office of Maples and Calder. He specialises in the acquisition and disposal of all types of commercial and high-end residential property, all aspects of property financing, commercial leasing, building and construction, tendering and procurement, as well as hotel and resort law. He also has experience in drafting and negotiating all property-related documentation.

PETER MADL

Schönherr Attorneys at Law

Peter Madl has been a partner with Schönherr since 1992 and is head of the real estate practice group. Besides the Vienna real estate practice, he oversees the property deals in the offices in Bulgaria, Poland and Ukraine. Mr Madl plays a central role in the firm's property-related mandates in Austria and further afield. With numerous transactions in central and eastern Europe under his belt, he is well equipped to advise Austrian and international investors and investment funds on property dealings in the region. Although Mr Madl's work is mainly of a transactional nature (sale and leaseback, acquisition), his activities also include the development of shopping centres and condominiums, and litigation.

Mr Madl, who is a member of the Vienna Bar, graduated from the University of Vienna (*Dr iur*, 1983) and the Vienna University of Economics and Business (*Mag rer soc oec*, 1987). He lectures on real estate law at the University of Vienna and on contract law at the Vienna University of Economics and Business.

NORIO MAEDA

Nishimura & Asahi

Norio Maeda is a partner with expertise in transactions involving the acquisition of, investment into and financing of Japanese real estate assets. He has represented domestic and foreign investors, including investment funds, financial institutions, investment managers and developers from the United States, Europe and Asia, in numerous investment and development projects involving sophisticated structures. He has also represented lenders in numerous structured finance transactions involving real estate assets. His expertise extends to the restructuring of distressed real estate asset investments. He is admitted to the Bars of Japan and New York.

MARC MEYERS

Loyens & Loeff Luxembourg Sàrl, Avocats à la Cour

Marc Meyers, partner, heads the Luxembourg investment management practice.

He has significant experience in structuring and transactional work concerning Luxembourg alternative fund structures such as SICARs and SIFs, with a particular focus on private equity and property funds. He specialises in all regulatory work involving fund and asset managers as well as other financial sector professionals.

In addition, Mr Meyers has extensive experience in handling matters involving multidisciplinary areas, including corporate, banking and capital markets matters.

Before joining Loyens & Loeff, he established and headed the Luxembourg legal practice of another Benelux law firm. He worked for several years in the Luxembourg office of a leading international law firm, as well as in the New York and London offices of the US firm Cravath, Swaine & Moore LLP.

He is a regular speaker at international seminars and an active member of several working groups within the Association of the Luxembourg Fund Industry and the Luxembourg Private Equity and Venture Capital Association.

Mr Meyers is a member of the Luxembourg and New York Bars.

TAMIRIS MICHELETTI BRITZKI

Aidar SBZ Advogados

A graduate in law from the University of São Paulo (2013), as a lawyer in the business and real estate financing areas of the firm, Tamiris Micheletti Britzki is responsible for developing real estate deals, providing legal advice in due diligence, and the transfer of equitable and ownership interests.

KATA MOLNÁR

Nagy és Trócsányi Ügyvédi Iroda

Kata Molnár is an associate at Nagy és Trócsányi. She joined the law firm in 2011. Dr Molnár gained her degree at Eötvös Lóránd Science University Faculty of Law in 2011. She acquired her BA degree in European business law in 2010 at the University of Abertay Dundee. She speaks Hungarian and English.

THORVALD NYQUIST

Deloitte Advokatfirma AS

Thorvald Nyquist is partner at Deloitte Legal in Norway and is head of the Deloitte real estate industry group. He has over 15 years of extensive experience within corporate and real estate law. Prior to Deloitte, he worked with Thommessen for seven years. In addition to his law degree from the University of Oslo, he holds a master's of business and administration from Berkeley.

Mr Nyquist receives instructions on a regular basis from real estate developers and commercial property owners in transaction and development issues. He also has extensive experience in complex lease disputes, in addition to assisting Deloitte Advokatfirma's tax department on restructuring issues where a solid grasp of real estate legal issues is required.

Mr Nyquist continues to attract a lot of media attention from leading publications within the commercial real estate business, and regularly writes articles for, *inter alia*, Hegnar Online, Estate Media and NæringsEiendom. He is also the editor-in-charge of all contracts and appurtenant documents in the real estate section of Gyldendal Rettsdata.

SILVIA OPRIS (NÉE POPA)

Schönherr si Asociatii SCA

Silvia Opris (née Popa), an attorney-at-law with Schönherr, specialises in real estate acquisition and development, real estate-related contract law and dispute resolution. She advises, *inter alia*, leading oil group OMV Petrom in the continuous development and upgrade of their network of filling stations, warehouses and refineries throughout Romania. Mrs Opris (née Popa) has extensive experience in projects related to contracting industrial equipment and technology as well as outsourcing matters, having assisted major developers in the successful negotiation and conclusion of various related contracts. She has also assisted clients in the development of renewable energy projects.

SAMULI PALIN

Krogerus Attorneys Ltd

Samuli Palin has over 15 years of experience in real estate, corporate and private equity transactions. Mr Palin has acted for both domestic and foreign real estate private equity investors as well as Finnish property and construction companies and institutional investors in both domestic and international real estate transactions. He also has extensive experience in real estate-related banking and finance matters as well as fund formation. Mr Palin co-heads Krogerus' real estate transaction practice group. He is recognised by a number of real estate sections of international legal publications, including *Chambers Europe*, *Legal 500* and *PLC Which lawyer?*. He is ranked by *Best Lawyers* as a leading real estate lawyer in Finland and by Euromoney's *Guide to the World's Leading Real Estate Lawyers* as an outstanding practitioner in this practice area.

NICOLAS PAPACONSTANTINOU

Papadopoulos, Lycourgos & Co LLC

Nicolas Papaconstantinou is a senior associate in the real estate practice group at the law office of Papadopoulos, Lycourgos & Co LLC, in Nicosia. He focuses his practice on real estate, wills and succession, energy and related litigation. He also deals with specialised transnational corporate and commercial matters.

Mr Papaconstantinou attained a BSc degree with honours in economics and politics at the University of Bath and, following postgraduate study at the London School of Economics, a master's degree in science in real estate economics and finance. In 2008, he graduated in law (LLB with honours) from City University, London. Drawing on his real estate, economics and finance background, he has added value to clients on several cases in his capacity as an advocate.

In 2013, Mr Papaconstantinou obtained a postgraduate certificate in oil and gas law at Aberdeen Business School, Robert Gordon University, and he is currently studying towards an LLM in oil and gas law at the same institution.

Mr Papaconstantinou is also a certified real estate valuer registered with the Scientific Technical Chamber of Cyprus (ETEK). He was admitted to the Cyprus Bar in 2009.

RODRIGO PERUYERO

Uría Menéndez

Rodrigo Peruyero is an associate in the Beijing office of Uría Menéndez. He joined the firm in July 2009 and previously worked at Linklaters (Madrid office) and DLA Piper (New York office). Mr Peruyero has extensive experience in corporate and commercial law and focuses on all sorts of commercial real estate transactions. He is admitted to practise in Madrid and in New York.

CHRISTOPHER PHILPOTT

Carey Olsen

Christopher Philpott is the head of the Carey Olsen property law group in Jersey and specialises in commercial property, both contentious and non-contentious. He joined Carey Olsen from the office of HM Attorney General for Jersey where he was a legal adviser (1996–2001) specialising in property transactions and related disputes involving the States of Jersey.

Mr Philpott leads on all commercial property transactions undertaken by Carey Olsen. He acts for global and local institutions on high-profile acquisitions, sales and lettings of commercial property in Jersey.

Mr Philpott became an advocate of the Royal Court of Jersey in 2001 and a solicitor of the Supreme Court of England and Wales in 2002. He became a partner at Carey Olsen in 2007, and head of the property law group in 2008.

BENJAMIN C ROSEN

Rosen Law

Benjamin Rosen is admitted to practice law in Mexico and the United States (Washington state).

His practice focuses on cross-border transactions, hotel, timeshare, resort and hospitality law, real estate law and development, foreign investment, corporate and finance. He links businesses, investors and entrepreneurs between Mexico and the United States, and shares his time between RosenLaw's offices in Los Cabos and San Diego.

Since 2005, he has counselled foreign investors and lenders in transactions representing more than US$400 million in Mexican real estate.

He is a frequent speaker on Mexican legal and international business matters at conferences, seminars and continuing legal education programmes in Mexico, the United States and Canada. He is also an active leader of the International Section of the American Bar Association (the ABA), and is currently the vice-chair of the Mexico, Latin American and Caribbean, and cross-border real estate transactions committees.

In 2012 and 2013, Mr Rosen was chief editor of the Mexico chapter of *Year in Review*, published by the ABA. He has authored articles published in various international business and legal media on topics including foreclosing on cross-border loans in Mexico; US–Mexico cross-border environmental and energy law; enforcing foreign judgments in Mexico; Mexican foreign investment law; and government bidding procedures.

He was an adjunct law professor at the Universidad de la Americas School of Law in Mexico City (1997–2004) and at the Seattle University School of Law in 2011.

He holds a bachelor of arts in political science from the University of Oregon (1992). He earned his *Juris Doctor* degree, awarded *cum laude*, from Seattle University (1996), and his Mexican law degree from the Centro Nacional de Evaluación para la Educación Superior (2009).

GUILLAUME ROSSIGNOL

De Pardieu Brocas Maffei

Guillaume Rossignol specialises in real estate investment transactions and in real estate finance.

Admitted to the Paris Bar in 2002, he graduated from the ESSEC (1999) and holds a master's degree in private law from the University of Paris II-Assas (2000). He was co-opted as a partner in 2008.

ANDREAS RÖTHELI

Lenz & Staehelin

Andreas Rötheli is an expert in corporate and M&A in Switzerland. He regularly advises on international and domestic transactions, including private equity buy-outs and transactional real estate matters. He leads the corporate and M&A practice group of Lenz & Staehelin in Geneva and is consistently recommended by many rating agencies in his practice areas.

Mr Rötheli attended the University of Geneva (*lic iur*), gained an MCJ from New York University School of Law, and is admitted to the Geneva and New York Bars.

NICK RYDEN

Shepherd and Wedderburn LLP

Nick Ryden has over 30 years' experience, during which he has acted in relation to all aspects of commercial property work in Scotland for developers, funders, investors and tenants, in particular the investment, acquisition and disposal and development letting and sale of retail parks. Mr Ryden is a governor and member of the Anglo American Real Property Institute, a member of the British Property Federation and a member of the Investment Property Forum. He is also one of the few Scottish solicitors listed in the real estate section of *The International Who's Who of Business Lawyers*.

IONUȚ SAVA

Schönherr si Asociatii SCA

Ionuț Sava, an attorney-at-law with Schönherr, specialises in real estate and corporate and commercial law. He has experience in projects related to the acquisition and development of real estate, having assisted developers in the conclusion of various related contracts, including construction agreements and lease agreements. Mr Sava has also assisted clients in dealing with the real estate aspects of the development of renewable energy projects.

YI-JIUN SU

Lee and Li, Attorneys-at-Law

Yi-Jiun Su, a partner at Lee and Li, Attorneys-at-Law, is qualified to practise law in Taiwan and New York. Ms Su specialises in the areas of real property, construction and infrastructure, corporate investment, government procurement and dispute resolution. Along with extensive experience in handling conveyancing, international engineering and construction works for a wide range of clients from different jurisdictions, she has represented investors, developers, equity funds, retailers and wholesalers, hotel and resort operators, contractors and consortia in matters involving conveyancing, leasebacks, public auctions of large properties, government procurement, and investments in and construction of power plants and other worldwide infrastructure projects. Ms Su has also represented several multinational companies in international construction disputes.

MAARTEN TINNEMANS

De Brauw Blackstone Westbroek NV

Maarten Tinnemans has worked with De Brauw Blackstone Westbroek NV since 2007. He is a senior candidate civil law notary in the real estate practice group and focuses on real estate funds, acquisition and divestment of real estate portfolios, controlled auctions and real estate finance. Mr Tinnemans has advised on numerous real estate transactions, tenders and many other real estate-related topics.

MARCELO JOSÉ LOMBA VALENÇA

Aidar SBZ Advogados

As head of the business and real estate financing areas of Aidar SBZ, Marcelo José Lomba Valença is responsible for developing real estate securitisation deals, providing legal advice in structuring investment funds and other assets pledged through real estate receivables. He has a law degree from the University of São Paulo (1993), a university extension in corporate law from Pontifícia University Católica of São Paulo and an LLM from Northwestern University, Chicago (2000). He is a professor at the School of Architecture at the University of São Paulo, where he teaches masters degree students. Mr Valença has been a member of a board of directors created to discuss the establishment of an agency to support the development of downtown São Paulo, and is the author of several articles published in magazines including *Banking Law* and *Capital Markets Magazine*.

MAX VAN DRUNEN

De Brauw Blackstone Westbroek NV

Max van Drunen is a senior candidate civil law notary specialised in real estate law and has worked with De Brauw Blackstone Westbroek NV since 2009. His practice includes large real estate transactions, securities, real estate funds and infrastructure. Dr Van Drunen has been involved in several transactions for foreign institutional investors, and is highly conversant with German law and business culture. Furthermore, he is a lecturer at Utrecht University and frequently publishes in the field of real estate law.

LOUISE WALL

Dentons

Louise Wall is an associate in the Doha office of Dentons specialising in commercial real estate and real estate finance transactions. She has extensive experience in both the UK and Qatar advising real estate owners, investors, operators, financial institutions and corporate occupiers on a broad range of real estate transactions. Her experience includes leasing and property management of office, retail, residential and mixed-use projects, sales and acquisitions, property investment joint ventures, mezzanine financing and security. She is also experienced in a variety of Qatar-based finance transactions, and regularly advises international banks and investors on the regulatory and licensing requirements for conducting business in Qatar.

Ms Wall first joined Dentons in 2006, relocating to the Doha office from the UK in 2008. She returned to the Doha office in September 2012 following a 12-month period working for a specialist commercial firm in the City of London.

ALEX WANG

Dentons

Alex Wang is a partner in the Shanghai office of Dentons. His practice encompasses a broad range of transactions, with an emphasis on real estate private equity, fund formation, corporate and M&A, and corporate and real estate finance.

Having practiced in the greater China region for more than a decade, Mr Wang has played a key role in representing international real estate investment funds, investment banks, financial institutions, multinational corporations and private equity and hedge funds in a variety of complex and innovative cross-border and domestic PRC transactions with respect to acquisitions, dispositions, joint ventures, structured finance, real estate development, public auctions and non-performing loan transactions in the PRC.

Mr Wang has written for *China Law & Practice* on regulatory matters in China.

DAVID WATERFIELD

Slaughter and May

David Waterfield is head of the real estate practice at Slaughter and May. He has broad real estate experience incorporating property development, the acquisition and disposal of investment property portfolios, the negotiation of commercial leases for both landlords and tenants, sale and leaseback transactions and structured financing.

Mr Waterfield has also been involved in numerous flotations, public offerings and securitisations, together with the real estate aspects of a number of high-profile international corporate mergers and acquisitions.

His clients include banks and insurance companies, developers, leading retailers, hoteliers and infrastructure funds.

ANNEMIEKE WESSELS

De Brauw Blackstone Westbroek NV

Annemieke Wessels is a civil law notary and partner with De Brauw Blackstone Westbroek NV. She heads the real estate practice group and focuses on project development, acquisition of real estate and real estate portfolios, restructuring of institutional and non-institutional investors' real estate portfolios, real estate funds, sale and leaseback structures, tenders or controlled auctions, real estate finance, securities and public–private joint ventures. She also advises clients on many other real estate-related matters (e.g., infrastructure issues). Ms Wessels advises Dutch and international institutional and non-institutional investors, pension funds, Dutch multinationals and other large companies, developers, construction companies, banks, non-profit organisations and municipalities, and others. She often works in close cooperation with De Brauw's other practice groups such as IMG and finance, creating a full range of services for all real estate-related projects for national and international key players.

WILL WHITEHEAD

Carey Olsen

Will Whitehead specialises in commercial property transactions and regulatory matters. Particular areas of practice include advising on commercial real estate acquisitions and disposals (both freehold and leasehold) and construction and development projects. He also advises on local property financing transactions (both commercial and residential).

Mr Whitehead acts for a number of international investors, local businesses and financial institutions, on a broad range of commercial property transactions. He is regularly instructed by telecommunications providers to advise on site acquisitions, and provides local planning and regulatory advice on development and construction projects.

Mr Whitehead joined Carey Olsen in 2005 and was admitted as a lawyer of the Supreme Court of New South Wales, Australia in September 2006.

NICLAS WINNBERG

Advokatfirman Vinge KB

Niclas Winnberg is a counsel at Advokatfirman Vinge. Since 2006, he has specialised in real estate law including real estate transactions, commercial leases and other rights of use. He also has wide experience of private M&A and financing. Mr Winnberg regularly advises clients in real estate transactions and various matters regarding rights of use. His clients include Swedish and international property companies, investment funds and financial institutions. He is ranked in *Chambers Europe* (2013).

STELLA G YANNIKA

Dryllerakis & Associates

Stella G Yannika is active in the fields of real estate, construction contracts, commercial and corporate law, and project finance. Before joining the firm, she served as legal adviser to Emporiki Leasing SA (2000 to 2006) and head of legal services of Ektasis Development SA (2006 to 2009).

Ms Yannika is a graduate of the Athens University Law School and has been a member of the Athens Bar since 1999. She is qualified to practise before courts of appeal of all jurisdictions. She speaks Greek and English.

ROBERT C YOUNG

Shin & Kim

Robert C Young, a senior US attorney, has been with Shin & Kim since January 1998. The focus of his practice is real estate, financing and mergers and acquisitions. He has been involved in a multitude of real estate projects, including representing foreign and domestic funds and companies in the acquisition and sale of existing commercial properties and development projects, and senior and mezzanine financing. Mr Young also has extensive experience with sale and leaseback transactions, as well as on general leasing matters. He received his JD from the University of California, Hastings College of Law, and clerked at the Hawaii Supreme Court.

TOMÁŠ ZÁRECKÝ

Zárecký Zeman Ďurišová Law Office

Tomáš Zárecký is a partner and head of the real estate department at Zárecký Zeman Ďurišová Law Office. He is also a recognised expert in the field of PPP infrastructure projects and public procurement. His extensive real estate experience covers advice in connection with the acquisition and sale of real estate, including legal due diligence, commercial leases, construction contracts and dealing with legal aspects of territorial and construction proceedings. He is further involved in the financing side of real estate transactions, focusing especially on loan agreements and related security instruments.

His clients include investors in the field of real estate as well as private equity funds, developers, banks and other financial institutions, asset managers, facility managers and municipalities. He complexly deals with all aspects of real estate transactions while he is frequently active in multidisciplinary teams together with real estate consultants, project managers, architects, engineers and other professionals.

He is regularly listed in the *Legal 500*.

Appendix 2

CONTRIBUTING LAW FIRMS' CONTACT DETAILS

ADVOKATFIRMAN VINGE KB
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