THE REAL ESTATE LAW REVIEW

SEVENTH EDITION

Editor
John Nevin

THE LAWREVIEWS

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Seventh Edition

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THE LAWREVIEWS

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PREFACE

I am delighted to introduce the seventh edition of *The Real Estate Law Review*. This edition extends to 35 jurisdictions, and we are delighted to welcome new contributions from distinguished practitioners from around the world. I am very grateful to each and every contributor for their hard work and essential role in the continued success of the *Review*. Each chapter provides an invaluable insight into key legal issues and market trends in the author's jurisdiction and, together, they offer an up-to-date synopsis of the global real estate market.

The *Review* seeks to identify distinctions in practice between the different jurisdictions by highlighting particular local issues. We believe that this offers investors and occupiers and their professional advisers an invaluable guide to real estate investment outside of their own back yard. The years since the first edition, back in 2012, have confirmed that real estate is a truly global industry. Overseas investors are increasingly prepared to look beyond traditional markets and sectors in order to exploit international opportunities as and when they arise. Often, investors need to act quickly and we hope that the *Review* provides an advantageous starting point to understanding cross-border transactions in the light of the reader's own domestic forum.

International economic and political instability continues to have a significant effect on the global real estate market. In the UK, Brexit generates uncertainty as the negotiations for leaving the EU continue. However, the continued attraction of UK real estate to overseas investors confirms that each event or development in a particular country must be seen in a global context to ascertain the bigger picture. It is no longer possible to ignore globalisation and view real estate markets in isolation. Brexit notwithstanding, the UK remains a safe haven for investors from around the world and this year has seen record levels of investment in central London from overseas buyers.

In addition to all the distinguished authors, I would like to thank the *Law Review* team for their tireless work in compiling this seventh edition of *The Real Estate Law Review*.

John Nevin
Slaughter and May
London
February 2018

Chapter 1

BREXIT AND REAL ESTATE

John Nevin[1]

I INTRODUCTION

Back in June 2016 the British electorate voted to leave the EU. Clients and their advisers must accept that Brexit is going to happen and identify the risks and opportunities that lie ahead, both in the near term and once Brexit has taken effect. After such a seismic event, uncertainty has proved to be the only certainty.

From the real estate perspective, the purely legal implications are of significantly less importance than the effect on market conditions. Perhaps the biggest concern is whether the UK (and London in particular) will continue to attract inward investment and retain its appeal as a country in which to do business and where people from around the world want to live. This will depend in part on the extent to which the UK's status is seen as dependent on its connection to the EU. Taking a more global view, it can be argued that the UK's position is such that membership of the EU has limited relevance and that London will remain a true global city irrespective of Brexit.

II TIME FRAME

The Prime Minister, Theresa May, has triggered Article 50 of the Lisbon Treaty and confirmed that the UK will leave the EU on 29 March 2019. The 2017 general election failed to give the Prime Minister the increased majority she was looking for to strengthen her government and drive through Brexit. Instead, the process has been made more difficult by a resurgent opposition, divisions in her own party and the need for a deal with the Democratic Unionist Party of Northern Ireland. A European Union (Withdrawal) Act (formerly known as the Great Repeal Act) will be used to remove the European Communities Act 1972 from the statute book and enshrine all existing EU law into British law. New legislation will be required to make any changes necessary to ensure that the adopted law continues to work and meets the UK's specific requirements. Brexit gives the UK the opportunity to choose those aspects of EU law that work while modifying or repealing those that do not. The process of modifying existing EU law will continue for a number of years as domestic law establishes its independence. Other necessary legislation includes a Trade Act to deal with the UK's post-Brexit trade policies and agreements and a Customs Bill to implement a new standalone customs regime. The Irish border issue, political instability in Germany and Spain, the risk of contagion arising among the remaining EU Member States and the threat of a second Scottish referendum are all factors with the potential to complicate the process further.

1 John Nevin is a partner at Slaughter and May.

III RISKS AND OPPORTUNITIES

The uncertainty surrounding Brexit needs to be considered in the light of continuing international economic and political concerns. Overseas investors will continue to look for attractive assets and income streams. Brexit notwithstanding, UK real estate has retained its appeal as a safe haven where businesses, individuals and funds can store, protect and grow their wealth. Indeed, there are a number of factors that have combined to make UK real estate an excellent investment opportunity. Perhaps of most significance is the ongoing weakness of the pound. Sterling plunged to a 30-year low following the vote, and the exchange rate remains very favourable to overseas buyers. Although the Bank of England has raised interest rates to 0.5 per cent, they remain at historically low levels and any further increases are likely to be limited and gradual. Unemployment remains low and there has been a slew of other better-than-expected economic data. In addition, a number of trophy assets have come to the market and the 'super prime' market in the residential sector has recorded significant price reductions because of falling volumes, creating a buying opportunity. These and other factors mean that the UK has become a slightly more affordable global property hotspot.

Uncertainty will continue as the UK proceeds with the extraction process. Negotiations with the EU and global trading partners are likely to be complicated and protracted, with the remaining EU members being very wary of being seen to give the UK a 'soft' deal. Concerns remain that businesses may seek to relocate or downsize their UK operations, and this is tied to fears about tighter controls on the free movement of people. Announcements of employees relocating have so far largely referred to inconsequential numbers. In addition to the effects on businesses generally, restrictions on immigration will be a particular problem for the construction industry, which is heavily reliant on the EU for skilled and non-skilled labour. In summary, the UK real estate market has held up better than many in the industry expected, but there will undoubtedly continue to be bumps and corresponding opportunities along the way as Brexit becomes a reality.

IV LEGAL IMPLICATIONS

As already mentioned, land law in the UK (or rather the three separate systems of land law within it) has remained almost entirely unaffected by the UK's membership of the EU. Brexit does not have any direct legal implications for the way in which UK land is held and dealt with. Overseas investors continue to be able to own, sell and lease UK real estate without any legal restrictions, and registration at the Land Registry affords secure title backed by a state guarantee. The impact on inward investment is more dependent on the wider economic and political considerations that come with UK independence and the form that ultimately takes. That is not to say that Brexit will not have an impact on real estate transactions – clearly, the market is driven by the need for occupiers and Brexit is going to have some impact over where businesses choose to locate. Property documentation will continue to reflect the ongoing uncertainty while the model and timetable for the UK's exit are determined. The trend towards shorter, more flexible leases will continue as occupiers monitor the position and weigh up their options. Break clauses, alienation provisions and rental structures will be a particular focus, both for new deals and for the re-gearing of existing leases. The rapidly expanding serviced office sector dominated by the likes of WeWork[2] provides occupiers with the flexible well-connected space they require during this period of uncertainty.

The position in relation to environmental and climate change law is very different. EU legislation governs the vast majority of the UK's environmental and climate change law and policy. This in turn affects the environmental aspects of the planning process. State aid and procurement and the Alternative Investment Fund Managers Directive are also governed by EU regulations. Brexit will have significant and direct implications in all these areas, although our expectation is that much of the environmental legislation is here to stay. Investors in infrastructure and energy will also be aware of the effect of Brexit, while the mining and minerals market will be less affected.

V CONCLUSION

Although it is impossible to predict the future, the outlook for UK real estate is more positive than had been feared, and there is some cautious optimism for the Brexit negotiations. Real estate practitioners can help their clients to develop an appropriate post-Brexit strategy to ensure that risks are assessed and monitored and opportunities are taken.

To many overseas investors the announcement in the Autumn Budget that gains made on disposals of UK commercial property by non-residents will be subject to tax is of far greater significance than Brexit. The government is consulting on the proposals and the new regime is due to come into effect in April 2019.

To achieve some perspective on the inevitable uncertainty, it is important to see Brexit in a global context. Concerns about North Korea, Chinese and other emerging market economies, the Trump administration, historically low oil prices, tensions in the Middle East and political instability in Europe all mean that UK real estate will retain its appeal for overseas investors. However, there is no room for complacency and it is clear that the UK must work hard to ensure that it remains attractive to investors and continues to play a key role in the global real estate market.

2 www.wework.com.

Chapter 2

ARGENTINA

Pedro Nicholson and Delfina Calabró[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

There are three main ways that an investor (either a physical person or a legal entity) may participate in the real estate market in Argentina:

a Ownership of the real estate property: 'real estate property right' is one of the limited *in rem* rights in Argentina. Although property rights have no time limits, they have to be exercised according to the terms and conditions set out in the Argentine Civil and Commercial Code (the Code).

b Participation as a shareholder in a company that owns real estate: this is the typical way to participate in the ownership of a property with a long-term commercial purpose (e.g., hotels, shopping centres, office buildings).

c Participation in a real estate trust: this a common way of temporarily participating in the ownership of real estate, for example, during the construction of the project. Trusts are generally meant as vehicles to guarantee parties' interests on real estate projects. In fact, in Argentina, trusts have been the most frequently used structures to counter the lack of banking finance in the past few years. It is worth noting that real estate investment trusts (REITs) do not yet exist in Argentina, at least, not in the same way as they are known in other countries (for example, offering tax benefits).

ii System of registration

Legal title to real estate requires:

a the execution of a sale deed that is passed before a notary public; and

b the transfer of the property.

Legal title is effective from the date of grant. However, to be fully enforceable against third parties, the title must be filed and registered with the real estate register of the relevant province.

The main information and documents that must be registered in the public real estate register are:

a public deeds creating, transferring, declaring, modifying or terminating interests in real property; and

b judicial decisions establishing attachments or other precautionary measures on real property, or restraining orders preventing the owners from disposing of the property.

1 Pedro Nicholson is a partner and Delfina Calabró is a lawyer at Estudio Beccar Varela.

Persons with a legitimate interest in discovering the legal status of the property, precautionary measures or restraining orders can request a special judicial authorisation to obtain a copy of the relevant title deed, recorded in the college of notaries in the province where the deed was granted.

The information available at the real estate register can be obtained through reports or certificates issued by it.

There is no specific state guarantee concerning the accuracy of records made by officers based on public deeds or other documents. However, any party incurring loss owing to a registration error can sue the state for damages caused by the inaccuracy of the real estate register. In any event, it is worth mentioning that the system of registries works quite accurately in Argentina.

Title insurance is not yet available, and it is unlikely that it will be available in the near future.

iii Choice of law

The Code foresees that any personal or *in rem* right to be granted or modified involving real estate located in Argentina shall be ruled as per the laws in force in Argentina. The Code further states that these matters shall be of the exclusive competence of Argentine justice.

II OVERVIEW OF REAL ESTATE ACTIVITY

Many key changes in the economy and in the business atmosphere in general have taken place since Mauricio Macri became president of the country in December 2015. These changes have been even more significant in the real estate market. From a market where no bank financing existed and projects were financed largely by private investors and through the pre-sale to final customers, Argentina is currently developing not only a 30-year mortgage market to finance principally the purchase of first homes, but also lines of financing for developers willing to build up their projects. This is a completely new scenario not only for the developers and investors, but for the real estate market as a whole.

In previous years, real estate projects – especially residential projects – were addressed mainly to the wealthier classes because, until 2015, to be able to acquire real estate in Argentina, one had to have funds on hand. For this reason, the emergence of financing, for both offer and demand, has been received as the news of the year in the Argentine market.

Further to the above, the good news regarding the Argentine market is that everything has yet to be done. Looking closely at the different sub-sectors of the market, there is room for expansion not only in the residential and office areas but also in the shopping centre and hotel markets. This will be further explored in Section IX, below.

III FOREIGN INVESTMENT

In Argentina, there are several restrictions to foreign citizens and companies, as well as certain requirements set for other persons, for the acquisition, lease or other kind of possession of real estate in the 'Border Security Zones'. Regulations determine which areas are included under this regime.

A special authorisation must be granted to complete the corresponding purchase in favour of foreign citizens and companies (both local and foreign), of Border Security Zones. The procedures for this authorisation may require between four and six months, although in some cases it may take longer.

It should be noted that, pursuant to Argentine legislation, local companies controlled by foreigners are considered as foreign companies (thus, differing from the regular principles regarding company regulation). Therefore, they are also required to obtain this 'permit', except for the acquisition of real estate located in urban centres.

Another restriction to foreign citizens and companies is related to the acquisition of rural land. On December 2011, the National Congress enacted Law No. 26,737 (the Rural Land Law), which sets forth the Protection Regime of the National Domain over the Property, Possession or Control of Rural Land in Argentina. The Law was further regulated by Decree No. 274/2012 and by Decree No. 820/2016.

For the purposes of the Rural Land Law, 'foreigners' are, among other things:

a foreign individuals, with or without a current address in Argentina (with certain limited exceptions foreseen in the Law); and

b foreign or local legal entities whose capital is owned by foreigners – companies or individuals – in a percentage higher than 51 per cent or in proportions that are sufficient to control the local company.

The Law provides five restrictions for foreign rural land owners:

a foreign individuals or legal entities may not own or possess more than 15 per cent of the rural lands in Argentina;

b foreign individuals or legal entities of the same nationality cannot own or possess more than 30 per cent of that 15 per cent;

c foreign individuals or legal entities may own up to 1,000 hectares in the 'nucleus area', or the 'equivalent surface' in other regions of the country (the Decrees specify those lands that are considered as 'nucleus';

d foreign individuals or legal entities may not own or possess rural lands containing or bordering large and permanent bodies of water, unless specifically authorised; and

e foreign individuals or legal entities cannot own or possess rural lands that are located in border security zones, unless specifically authorised.

The Law also provides that the National Registry of Rural Land is empowered to initiate administrative proceedings to investigate possible breaches of the Law.

Notwithstanding the above, real estate property that is not located in a rural land zone or in a border security zone, has no restriction for foreigners' acquisition, lease or possession.

IV STRUCTURING THE INVESTMENT

As mentioned in Section I, above, there are three main ways through which an investor can participate in the real estate market:

a the direct acquisition of real estate;

b the participation as shareholder or partner in a company that owns real estate; and *c* under a real estate investment trust: in which case, the real estate investment will be canalised through the investor's interest in a real estate investment trust, to later obtain the deed of the plot or unit subject matter of the transaction, or the result of its commercialisation through the trustee.

In most cases, the decision on how to take part in a real estate transaction is not taken by the investor, but, on the contrary, is often taken by the seller or the developer based on quite diverse issues, especially tax reasons.

In every case, it should be analysed whether the stamp tax is applicable. It is recommended to seek advice on this aspect and on any and all other accounting or taxing matters before executing any kind of agreement.

From a legal point of view, when real estate is purchased, together with the assessment of permits, tax status and technical viability of the premises or the project, the certificate of title issued by the real estate registry should also be obtained, with the purpose of proving ownership and existence of taxes levied on the property. In all cases, before the execution of any arrangement it is advisable to carry out a detailed audit or due diligence on the various aspects regarding the transaction:

a aspects related to the parties of the transaction;

b aspects related to the object or purpose of the transaction (real estate, ownership background, its conditions, the legal and administrative status, the environmental situation, etc.); and

c aspects related to the target project or development (feasibility, applicable regulatory framework, etc.).

This legal audit should be completed simultaneously with other similar analysis and studies carried out by other areas or specialties: notary public, accounting and financial advisers, architects, engineers, land surveyors, etc.

On the other hand, the decision to acquire shares in a company implies a more complex analysis: besides the above-mentioned real property assessment, a profound investigation (also due diligence) should be carried out within the legal, accounting, fiscal and financial framework of the target company, with the purpose of learning about its situation, the contingencies or liabilities held by the target company, etc., and thus, for example, being able to negotiate discounts or adjustments of the purchase price or to avoid, or at least mitigate, future contingencies.

Finally, when acquiring shares in real estate developers, the analysis should include the review of the criteria used by the promoter to assess the different projects in which he or she takes part (generally, through real estate subsidiaries or trusts), because those criteria may sometimes differ from the ones applied by the investor in his or her own accounting and practices. Eventually, this will bring a different result in the valuation process of the target company or the asset.

V REAL ESTATE OWNERSHIP

i Planning

As a federal country, Argentina has three spheres of government that may share jurisdiction over planning control and uses assigned to real estate property. The type of investment to be held on the said properties will determine the jurisdiction entitled to follow and control the developing processes, so establishing the competent authorities.

As an example, planning control issues regarding real estate construction investments are, in general, assigned to local authorities (usually municipalities) who tend to regulate the said matters using edification or zoning codes. These regulations determine the possible –and so authorised – uses for the property they control. Sectoring and activity availability are generally distinguished according to population and geographical issues, providing restrictions within developing businesses and possible changes of use in relation to the original destination of the properties.

ii Environment

Pursuant to the Code, damages caused as a consequence of the development of dangerous activities are subject to a liability regime similar to that applying to damages caused by or with dangerous objects. Anyone who performs a dangerous activity may be held liable for damages caused to the environment as a consequence of such activity.

In that respect, any injured person may seek damages from the owner or keeper of an asset that produces environmental damage. Likewise, the transferor of an asset that has a defect and later causes environmental damage may be liable even after the transfer. A five-year statute of limitations applies to environmental damages.

The owner or keeper of a dangerous object or activity that causes damages to the environment may be excused only in case of *force majeure* or when a third party or the victim has contributed to the damage. The Code provides joint liability for damages caused by a person who is part of a group or by an activity performed by a group.

Also, under Law 25,675, in the case of collective environmental damages caused by legal entities, liability can be extended to their managers, director, statutory auditors or other officers who participate in the company's decision.

iii Tax

In Argentina, there are three different levels of government authorities that can levy taxes, the main ones being the federal government and the provincial government. Hence, the acquisition of real estate property may be subject simultaneously to different taxes imposed by the different levels of government.

Regarding federal taxes, the sale of real estate property performed by legal entities – both foreign and local residents – shall be subject to income tax at a 35 per cent rate on the purchase price. Foreign residents shall pay the due tax by means of a withholding regime. The sale of real estate property owned by a foreign resident is levied at a 35 per cent rate over either (1) 50 per cent of the gross value paid – that is an effective rate of 17.5 per cent; or (2) the purchase price minus the expenses incurred to obtain and maintain the source of income – that is 35 per cent over the net value. The beneficiary may choose which of the taxable bases mentioned will be applied.

However, the sale of real estate property by individuals – both foreign and local residents – is subject to the tax on real estate transfer, at a 1.5 per cent rate on the purchase price.

As a principle, the sale of real estate property is not subject to VAT. Nevertheless, if the seller of a construction built on his or her own property is considered to be a 'construction company' pursuant to the definition set forth by the VAT Law, said principle will not apply and the sale of the building on the property may be subject to VAT (the value of the building by itself and not the land could be subject to this tax). The general rate is 21 per cent; however, a reduced rate of 10.5 per cent may be applied to the sale of residential real estate property.

On 15 November 2017, a bill to amend the federal tax regulation was presented before Congress. Should this bill be passed, the analysis mentioned above may change.

Concerning provincial taxes, the acquisition of real estate property may be subject to stamp tax. This tax is levied on the execution of agreements and is estimated on the economic value of the agreement. The applicable rate differs from one jurisdiction to another, ranging from 2 per cent to 5 per cent.

VI FINANCE AND SECURITY

The most common forms of securities granted over real estate property in Argentina are through mortgages or a trust.

According to the Code, a mortgage is an *in rem* right of guarantee. The mortgage connected to the affected real estate property continues in the possession of the owner of the property. If the owner does not comply with the obligations of the mortgage, the creditor will have the faculties of persecution and preference in order to collect the credit guaranteed. The maximum term of existence of a mortgage is 35 years, and it can be renewed as many times as needed.

The trust is also regulated in the Code. There is a trust agreement whenever a party (or 'grantor') transfers or undertakes the obligation to transfer the property of certain assets to another person (or 'trustee') who is obliged to manage that property in trust in benefit of another person (or 'beneficiary') who is established in the contract, and to transfer that property in an established period of time or upon the fulfilment of an established condition, to the beneficiary or to another third party. The trust is just an agreement and not an entity (as are the 'trusts' in Anglo-Saxon legislation). Trusts are just agreements that create a separated patrimony in the head of the trustee, to be governed as per the rules foreseen in the trust agreement. The trust has a maximum term of 30 years after the execution of the trust agreement, and can be renewed as many times as needed. As a guarantee, a trust is more practical than a mortgage, because the terms of its execution may be specifically foreseen in the agreement itself, while the mortgage may just be executed through an auction process.

VII LEASES OF BUSINESS PREMISES

In Argentina, commercial leases have a minimum two-year term and a maximum 50-year term.

Although inflation has been reduced in the past two years, there is still inflation that needs to be addressed. As from the 1991, Argentine legislation prohibits currency update and price indexation. Inflation (and the resulting indexation prohibition) is mitigated in leases with a price escalation system in which the price is pre-stated for the first two or three years. When the term is longer, parties agree on having a further negotiation process and if the latter fails, an expert (broker's) determination of the price for the years following such process is established.

Leases are strongly protected by law. If the landlord transfers the property to a third party, the existing lease shall prevail and the new owner of the real estate will have to respect all the terms and conditions of the lease in force.

Argentine law provides an early termination mechanism of lease agreements, through which the tenant is able to terminate the contract unilaterally after six months of a lease agreement have elapsed. According to law, the amount of compensation will depend on the time when the tenant decides to terminate the contract. In certain cases, however, this conclusion might be somehow altered, depending on the evolution of the new jurisprudence to be developed on the matter, in light of the terms and conditions of the new Code.

VIII DEVELOPMENTS IN PRACTICE

There are many new developments taking place in the Argentine real estate market. As already described, Argentina is going through a period in which markets are being opened for foreign investors, and many barriers have already fallen, especially regarding foreign exchange restrictions that had obstructed investments (foreign and local) in the market in prior years.

A foreign investor (or foreign developer) entering the Argentine market to develop real estate business should bear in mind, among other things, the following developments that are currently taking place.

i Loans for residential projects

As described above, the mortgage system in Argentina was almost non-existent until mid-2017, and with certain exceptions (see Section VIII.ii, below), in order to be able to acquire a home, a purchaser required the funds to fully pay the purchase price for a residence. From the second half of 2017, banks (national and private) began to grant 30-year mortgage loans in Argentine pesos for housing. These loans have been further backed by specific regulation from the Central Bank. The banks have likewise been flooded with requests from prospective residential purchasers, which, on the other hand, caused an increase of the end price for housing. This is, without question, the main development taking place in the real estate market, because many paradigms have changed, not only in the developers' minds and way of legally structuring real estate projects, but also in the purchasers' minds, because new alternatives to participate in the market are suddenly appearing.

ii Loans for developers

In the past, developers conducted residential projects through trusts, where the purchasers could finance the purchase of their homes in installments, as per the financing needs of the construction of the project (i.e., usually in these cases, the developer just received a fee). This way, not only the end purchaser could finance the purchase of a home (although not in long terms), but the developer could also finance the construction of projects as well.

In the way described in Section VIII.i, above, though still somewhat reluctantly, loans for developers are being granted by banks – something that was non-existent in prior years. This will also change the way developers structure their projects, opening many alternatives for development that simply did not exist before.

iii New foreign institutional investors and new foreign developers

Since 2016, many foreign institutional investors have entered the Argentine market, investing in immediate projects as well as participating in the shareholding of local developers. Further to this, some renowned foreign developers have entered the market, beginning to develop projects by themselves and also co-developing projects with local developers.

This scenario will surely be disruptive to the market as we have known it in the past years. We are in a period in which many things are yet to change, and both developers and investors are bound to adapt.

iv New Civil and Commercial Code

In mid-2015, a new Civil and Commercial Code came in force in Argentina, replacing the Civil Code and the Commercial Code that had been in place for 150 years. A new jurisprudence has yet to be developed, and likewise, 'interpretation' of the new Code is still lacking in many areas.

In any event, the new Code foresees new regulation that will impact on the real estate market. These include the following:

a The new Code created a new 'right of surface' that will no doubt be a very attractive tool for developing projects where a construction capacity is available and subject to being commercialised (i.e., not only for pieces of land, but also for buildings already in place). This new tool, in our opinion, has not yet been 'discovered' by the local developers, but once the new right of surface become apparent, it will be a very practical tool to develop projects in ways that are not currently pursued.

b Some new property rights were further created; among them, the condominium right (i.e., *propiedad horizontal* or horizontal property regime), which amended the existing rules regarding those types of rights. This new condominium right rules on the development of all closed neighborhoods, whether they are plain gated communities or country clubs. Further, the new Code foresees that all closed neighborhoods not already organised as per the rules of the new condominium right will have to adapt their legal structure accordingly.

c Real estate trusts have been the most popularly used vehicle for structuring real estate projects during the past 15 years. With the new Code, the structure of these trusts will have some amendments that shall not affect their existence or application, but nevertheless should be borne in mind.

d Lease agreements will have a maximum term of 20 years for residential purposes, and of 50 years for all other purposes. This amendment is very positive, because the maximum 10-year term of the prior law had proved to be insufficient in many cases (e.g., when a future lessee had to make a big investment, the 10-year term usually turned out to be very short and inadequate to amortise the capital invested).

e Previously, the constructor (together with certain professionals, such as the architects involved) was the only one responsible for the total ruin or destruction of the work. However, with the new Unified Code, the developer will also have responsibility. We gather that new insurance policies will have to foresee the coverage of these new responsibilities.

As described, the new Code has brought many amendments to the laws and regulations that applied to the real estate market (i.e., the ones described above are just a few of them). This will no doubt impact on the way real estate projects are instrumented in the future, and it will be a great challenge for lawyers to be innovative within the new legal scenario.

IX OUTLOOK AND CONCLUSIONS

It is expected that 2018 will be a standout year for the real estate market in Argentina.

As mentioned in Section II, above, there is an optimistic atmosphere in the real estate market, mainly caused by key decisions that are being taken in the economy as a whole that are impacting the sector.

Argentina has an incredibly beautiful landscape with many different types of scenery (i.e., from the countryside to the mountains, from the glaciers to the beaches) and gorgeous cities – especially its capital city, Buenos Aires, with its European architecture and layout. As already mentioned, the good news for anyone willing to participate in the Argentine real estate market is that everything is still to be done. From road infrastructure onwards, the variety of investment needs is ample.

Regarding different subsectors of the real estate market, the status and perspectives are as follows.

i Residential market

The residential market has a great margin for development because there is a large housing shortage, especially for the lower and middle classes. During the past 15 years, this market has almost completely lacked financing, obliging purchasers to pay the whole purchase price upfront when executing the purchase deed. As one can imagine, this could only be done by a very small percentage of the population. Inflation has also left its mark here. For this reason, with the new existing financing for end customers (mortgage financing) and for developers, the opportunities in this submarket are indeed important.

ii Hotels

Argentina is one of the top tourism destinations in Latin America. This has pumped the hotel market countrywide, though in many medium and large cities in the provinces of Argentina, as well as in the city of Buenos Aires itself, there are still very good opportunities for expansion, especially bearing in mind the new air routes being granted to new airlines starting business in Argentina.

iii Shopping centres

There are cities in the provinces with a population of over 100,000 that have a very decent income, which have no shopping centres. There are also some big cities with just one or two shopping centres. This market, therefore, has much room for growth.

iv Offices

The office market basically goes hand in hand with the economy as a whole. In this sense, as the economy in Argentina is beginning to grow at a steady pace, there will be many opportunities in the office market (especially in AAA offices with LEED certification, which is slowly growing in our country).

v Rural land

Although Law 26,737, enacted in December 2011, limits the ownership of rural land by foreigners, this may lease rural land without limit, and of course participate in agribusiness pools who invest in Argentina's farmlands. The farm business in Argentina has been historically very promising, although in the past years it has been somehow drowned by the incredibly high taxes imposed by the authorities on this market (which is, again, something that is expected to change this year).

As described above, the expectations in the market are high and the opportunities many.

From a strict legal standpoint, the application of the new Code will also bring new scenarios to explore, which may create opportunities that are not yet deeply developed, including the application of the new surface real estate right, the interpretation of the scope for lease agreements, the new guaranty obligations for developers and the new legal structure for condominium projects. Again, 2018 and the years to come are expected to be a turning point for the Argentinian market.

Chapter 3

AUSTRALIA

Anthony J Cordato[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

Freehold title is by far the most common form of ownership for real estate in Australia. Houses, apartments, commercial buildings, farms and vacant land are examples of real estate with freehold title.

Freehold title means that the owner (and their beneficiaries) owns the real estate outright in perpetuity. The owner is free to mortgage the real estate to secure a loan, to lease the real estate, to gift the real estate, to leave the real estate by will and to sell the real estate. The owner is free to build, add to and demolish, subject to planning permits.

Strata title is the other common form of ownership. It is found in medium-density and high-rise buildings where self-contained parts of the building – strata apartments (also known as home units or 'lots' in a strata plan) have a separate title. Apartments, townhouses, strata offices, strata shops and strata industrial units are examples of real estate with strata title.

Strata title gives the owner the same rights as the owner of freehold title real estate, except that decisions upon the building, such as repairs and maintenance, are made collectively by all the owners of the building, and common levies are raised for insurance, repairs and maintenance.

Some specialised forms of ownership in Australia are:

a Crown leases, which is leasehold title found in farms and rural properties;
b community title, which is found in residential developments ranging from low-density to high-density, and retirement villages;
c maritime and foreshore leases of 99 years for land near waterways;
d company title, which is found in older residential apartment buildings; and
e native title, which is found in pastoral and mining leasehold land.

ii System of registration

Ownership of real estate is transparent in Australia. There is a record of the name of the legal owner of the real estate in the land titles registry located in each state and territory in Australia. Not only is the legal owner recorded, but also easements and covenants affecting the land, mortgages that are secured by the land, claims of interest (caveats) made upon the land and leases of the land. The price paid to purchase property and the rental payable on the lease are transparent, but not the amount owed under a mortgage security.

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The recordings are made on a certificate of title. A separate certificate of title exists for every parcel of real estate in Australia. This idea originated from Robert Torrens who in 1858 introduced the system of transferring title to property by means of the registration of a transfer of title on a certificate of title. This system is known as 'Torrens Title', and is used for all forms of ownership of real estate in Australia.

Legislation in Australia confers statutory protection, known as 'indefeasibility of title', upon the person who is recorded as owner on the certificate of title at the land titles registry. The sole exception is if the transfer is fraudulent. In practice, this means there is a state guarantee of good title given to a purchaser when they purchase a property.

iii Choice of law

There is no choice of law available in Australia when it comes to dealing with real estate.

The law that applies to dealings with real estate is the law of the state or territory in Australia in which the real estate is situated. The exception is if the real estate is owned by the Commonwealth of Australia, in which case Commonwealth Law (Federal Law) applies.

II OVERVIEW OF REAL ESTATE ACTIVITY

These figures from the Australian Bureau of Statistics paint the picture of a buoyant real estate market:

a The total value of residential dwellings in Australia was A$6,726,783.5 million at the end of the June quarter of 2017.

b The mean price of residential dwellings in Australia rose A$12,100 to A$679,100 at the end of the June quarter of 2017 and was up by 10.2 per cent in the year to June 2017.

c Price increases for residential real estate varied considerably around Australia. The three capital cities that exceeded the mean price increase of 10.2 per cent for the year to June 2017 are: Sydney – 13.8 per cent, Melbourne – 13.8 per cent, Hobart – 12.4 per cent. The other capital cities were more subdued: Canberra – 7.9 per cent, Adelaide - 5 per cent, Brisbane – 3 per cent, Perth – minus 3.1 per cent and Darwin – minus 4.9 per cent.

d The number of residential dwellings in Australia rose by 40,000 to 9,906,100 in the June quarter of 2017.

e Seasonally adjusted, approvals for private houses rose 5.5 per cent, and approvals for other private sector dwellings (mainly apartments) fell 18.4 per cent in the year to December 2017.

f Seasonally adjusted, capital expenditure on commercial buildings and structures rose 2.4 per cent in the year to September 2017.

g Lending to investors is falling, while lending to owner occupiers is rising, partly as a result of an interest rate premium being charged to investors compared with owner occupiers, and partly as a result of lending policy favouring owner occupiers.

III FOREIGN INVESTMENT

Australia is open to foreign investment in real estate in new residential housing (up to 50 per cent of an apartment development can be sold to foreign investors), commercial real estate and farms.

Investment in existing housing stock is restricted to Australian citizens, permanent residents and holders of student visas. The 'existing house' policy is directed at housing affordability for the average Australian, so that they are not crowded out or priced out of the housing market.

This is the foreign investment policy as explained by the Foreign Investment Review Board:

> *Under Australia's foreign investment framework, foreign persons generally need to apply for foreign investment approval before purchasing residential real estate in Australia.*
>
> *Foreign investment applications are considered in light of the overarching principle that the proposed investment should increase Australia's housing stock (by creating at least one new additional dwelling).*
>
> *Strict criminal and civil penalties may apply for breaches of the law, including disposal orders. Foreign persons may be required to notify and receive a no objections notification before acquiring an interest in commercial land in Australia. Different rules apply depending on whether the land is vacant or not, whether the proposed acquisition falls into the category of sensitive commercial land that is not vacant, and the value of the proposed acquisition.*
>
> *Proposed direct interests in an agribusiness generally require approval where the value of the investment is more than $55 million, with an exemption applying to investors from Australia's trade agreement partners and a $0 threshold applying to Foreign Government investors.*

In 2015–2016, the Foreign Investment Review Board approved 41,000 purchases of residential real estate by foreigners nationwide, with 44 per cent in Victoria and 33 per cent in New South Wales. For various reasons, this represents a high water mark and foreign purchases have declined subsequently. Most approvals are for purchases of A$1 million or less in price, which indicates that the properties purchased are mostly new strata apartments.

IV STRUCTURING THE INVESTMENT

Investors in real estate in Australia have a wide choice of structures and investment vehicles in which to make their investment.

The most popular forms for direct investment are: personal name, a company, a trust or a joint venture. Each have their relative advantages in terms of asset protection, taxation treatment, ease of transacting, disclosure and sharing ownership.

The most popular form for indirect investment is a property scheme, which can be a listed real estate investment trust (REIT) or an unlisted property scheme.

i Personal names

Real estate held in a personal name is exposed to creditors and others who make legal claims.

Why is it that most Australians own their family home in their own names with this exposure? The answer is that the family home has many tax exemptions – the sales proceeds are completely exempt from capital gains tax, the home is exempt from annual land tax and no inheritance tax is payable on death. Investment property has no such tax exemptions.

Transacting is subject to full transfer taxes (known as stamp duty), no matter if it is a family home or an investment property. If ownership is shared, the names of all owners are recorded on the title.

ii Company

Real estate held in the name of a limited liability company protects the shareholders and directors of the company from legal claims against the property. The exceptions are director liabilities for personal guarantees, tax and environmental offences. Companies are useful for joint ownership of properties for investment.

Real estate investment companies pay tax at the rate of 30 cents to the A$1. If more than 20 cents in the A$1 of income is 'active' income, the rate may be lower. The tax paid is able to be distributed as a tax credit against the Australian tax payable by the shareholder.

Transacting is subject to full transfer taxes, whether by the company or by the shareholder. The ownership interests are held as shareholdings.

iii Trust

Real estate held in a trust is usually held in the name of a limited liability company, which acts as the trustee of the trust. The trustee is usually able to deal with the real estate in its name, as if it were the owner. The trust protects the real estate assets against legal claims made against the trust beneficiaries personally.

There is no income tax payable by a trust because the profit is distributed to the beneficiaries annually. Tax is payable by the trust beneficiaries on the trust distributions at rates according to their tax position.

If the trust is a unit trust, then the distributions made to the trust beneficiaries are fixed, according to the unit holdings. If the trust is a discretionary trust, then the distributions are made at the trustee's discretion. If the trust is a custodian trust (a bare trust), then the trust beneficiary or beneficiaries are entitled to fixed distributions.

Transacting units in a unit trust follows the same rules as transacting shares in a company, namely that the requirements of the unit trust deed must be followed.

Interests in a discretionary trust are not transacted because the beneficiaries have no fixed entitlements, only an entitlement to be considered for a distribution.

Transacting interests in a custodian trust follows the same rules as transacting interests in a personal name.

iv Joint venture

Real estate held in a joint venture can be held in any one of three ways:

a in the name of a company. If so, it is an incorporated joint venture and the commentary about companies and unit trusts applies;

b in the names of the investors personally – the joint venturers. If so, it is an unincorporated joint venture and the commentary about personal names applies; and

c in the name of a nominee company. If so, it is an unincorporated joint venture and the commentary upon custodian trusts applies.

v Property scheme

This description is provided by the Australian Securities and Investments Commission:

> *A property scheme, also known as a property fund or property syndicate, is an investment where you, and other investors, buy 'units' in an investment operated by a professional investment manager. The scheme's money is invested in property assets which may include commercial, retail, industrial or other property sector assets.*

> *The investment manager selects and buys investment properties and is responsible for maintenance, administration, rental collection and improvements to the properties.*
>
> *Your money usually stays in the property scheme until it ends, when the properties are sold and the net proceeds are distributed to investors.*
>
> *You may be able to withdraw your money early but there may be penalties. If the scheme is listed, you may be able to sell your units on the public market.*
>
> *Depending on the type of property fund you invest in, you might get a regular income (distributions), usually quarterly or half-yearly, and a capital gain on your original investment, if the value of the scheme's underlying investment assets increases.*
>
> *Some property schemes invest in property development, which means there are extra construction and development risks.*

Listed property schemes, known as property trusts or REITs, are property schemes listed on a public market, such as the Australian Securities Exchange. They are easy to value, easy to sell and are subject to listing (disclosure) rules.

Unlisted property schemes provide less liquidity for their units, and are less transparent in terms of disclosures to investors.

In terms of taxation, the commentary upon unit trusts applies because that is their structure.

V REAL ESTATE OWNERSHIP

i Planning

Town planning schemes, land zoning and development controls provide the legal framework for the way that land can be used in Australia.

Planning rules are strictly enforced. Illegal development will be subject to use prohibition orders and demolition. For that reason, checking planning and building compliance is a vital part of the conveyancing process for the purchase of property.

Common land zonings are: residential (low density, medium density and high density), rural, business, general commercial, tourist, industrial, mixed zoning and environmental. Each zoning has rules for exempt development (which does not need a permit), complying and permissible development (which needs a permit) and prohibited development.

Checking building compliance is an important part of the conveyancing process when purchasing real estate in Australia.

Complying with the planning rules to develop a property in Australia requires expert assistance from specialists such as town planners, traffic consultants, environmental consultants, land surveyors and lawyers.

Local authorities (local councils) determine applications for development permits or approvals, except for state significant applications, which are determined by the state departments of planning.

ii Environmental

Each state has an environmental planning authority that regulates the investigation and clean-up of contaminated land to prevent pollution and safeguard community wellbeing. The planning and development process determines what remediation is necessary to make contaminated land suitable for use.

Examples of contaminated land are land that is in a locality where heavy industry or intensive agriculture is found, or individual sites that have been used for chemical storage, such as petroleum service stations, and sites with asbestos materials in buildings or in the soil.

If a property is purchased for development, especially for residential development, obtaining an environmental impact statement is an important part of the conveyancing process because the contract for the sale and purchase of land will normally contractually preclude the purchaser from making any claim against the seller. If there is contamination, the purchaser should request that completion of the contract be made conditional upon the issue of an environmental clearance certificate.

If a property is purchased as an investment then an asbestos clearance may be appropriate for loose-fill asbestos insulation in the roof cavities of houses, and for asbestos lagging around pipes, asbestos roofing and in electrical boards in commercial buildings.

iii Tax

Transfer tax, known as stamp duty in Australia, is levied on transfers of real estate in Australia. It is payable by a purchaser either within a fixed period after the contract is entered into, or on completion of the contract, depending on the state.

The rate of duty varies according to the price in the contract for the sale and purchase of the real estate, unless it is a gift or a transfer between related parties, when the rate is according to the market value of the real estate.

The rate of duty varies between the states and territories. Exemptions can apply to first-home purchasers. Stamp duty surcharges apply to foreign purchasers in New South Wales, Victoria and Queensland.

This is a snapshot of the current stamp duties payable:

a New South Wales – for an A$800,000 property, the stamp duty payable is A$31,490. An 8 per cent surcharge is payable by foreign purchasers of residential property, which adds another A$63,490. There is no surcharge for commercial property.

b Victoria – for an A$800,000 property, the stamp duty payable is A$43,070. A 7 per cent surcharge is payable by foreign purchasers of residential property, which adds another A$56,000.

c Queensland – for an A$800,000 property, the stamp duty payable is A$21,850. A 3 per cent surcharge is payable by foreign purchasers of residential property, which adds another A$24,000.

iv Finance and security

Australian real estate is acceptable security for loan finance. Lenders require 'first mortgagee' status, which is that their mortgage is the first mortgage recorded on the title to the property. The reason is that in the event of default, the lender has the right to sell the property in its capacity as mortgagee exercising its power of sale. This right is not restricted by subsequent mortgages or other interests recorded on the title to the property.

The availability of loan finance for Australian real estate is governed by two factors:

a The status of the borrower. Are they a resident or non-resident? Are they purchasing for owner-occupation or for investment?

b The nature of the property. Is it residential – a house or an apartment? Is it commercial – a hotel, retail, industrial or office? Is it agricultural – a farm or other rural property? If commercial, what is the remaining term of the lease and the quality of the tenant?

The factors translate into whether or not loan finance is available, the interest rate payable and the loan-to-value ratio that will apply.

VI LEASES OF BUSINESS PREMISES

Commercial properties are usually sold subject to lease. Evaluating the quality of the lease is essential. The main characteristics of leases of business premises in Australia are as follows.

i Term

Typical terms are two, three or five years, with an option to renew for the same term. Tenants with extensive fit outs, such as restaurants, food outlets, retail shops and cafes prefer five-year leases with at least one, if not two, options to renew for a further five years. The option to renew is exercised at the discretion of the tenant. Demolition clauses are inserted into leases of buildings that are intended for redevelopment, which enable the lease to be terminated early without liability to the tenant.

ii Commencement

If a tenant pre-commits to premises in the course of construction, then an agreement for lease is entered into as a precursor to the lease. The agreement for lease often contains the specifications, such as services, air conditioning and configuration, that the tenant requires. The tenant may negotiate a rent-free fit out period.

iii Rent

The rent is stated in the lease as either a gross rent (inclusive of outgoings) or a net rent (outgoings are added). Residential rents are always gross rents (by law); office rents tend to be gross rents; industrial and retail rents tend to be net rents.

For these purposes, outgoings include council rates, water rates, strata levies, land tax, building insurance, management fees, building repairs and maintenance. Outgoings do not include services such as electricity, gas, telecommunications, water usage, waste and other garbage removal, which remain the tenant's responsibility.

Goods and Services Tax (GST) is payable on commercial rent (the current rate is 10 per cent). It is added to the rent. GST is remitted quarterly to the Australian Tax Office. No GST is payable on residential rents.

Some shopping centre leases contain turnover rent clauses. Turnover rent is payable in addition to normal rent, based on a percentage of the turnover.

Rent is usually paid monthly in advance. The annual outgoings are divided by 12 and are payable along with the rent, if the rent is a net rent.

Typically, rent increases annually by either consumer price index or by a fixed percentage, or by the higher of the two. Rent is reviewed to market at the commencement of the option term. The lease should contain a 'ratchet' clause, which prevents the rent from falling below the rent for the final year of the previous term, when the rent is reviewed to market.

A rent-free period is often negotiated for the first term, the length of which depends on the tightness of the rental market. It can be one month per year in a normal market.

iv Security bond

A cash security or bank guarantee of three month's rent is typical for commercial leases. The amount can be increased every time the rent is reviewed. Cash bonds are held by the landlord, except retail premises bonds, which are held by a rental bonds board. Personal guarantees are common, although their usefulness is limited because a lawsuit is needed for collection, or because the guarantor often becomes bankrupt if the business fails.

v Use

The use is specified in the lease either in specific terms such as a cafe, or in general terms such as a warehouse. Usually, the use must be approved by the local planning authority. The use cannot be changed without the landlord's consent.

vi Assignment and sub-letting

The tenant has the right to assign the lease and to sub-let the premises, with the landlord's consent. The landlord can require the incoming tenant to have suitable experience and financial resources.

vii Make good

At the end of the lease, the tenant is required to 'make good'. This means that the tenant must hand back the premises in the condition and state of repair that it was handed over to them, fair wear and tear excepted. The tenant must remove their fit out, and repaint the premises. The tenant must decontaminate if their use has caused contamination.

viii Insurance

The landlord is responsible to insure the building (except in strata properties, where the strata corporation does so), for public liability and for fittings. The tenant is responsible to insure for public liability, plate glass (if any) and worker's compensation.

ix Energy efficiency

Owners of commercial office space with a net lettable area exceeding 1,000 square metres must provide an up-to-date building energy efficiency certificate (BEEC) and provide it to tenants before leasing and purchasers before selling the office space. The Commercial Building Disclosure (CBD) Program requires BEECs to contain a National Australian Built Environment Rating System (NABERS) for offices rating and a CBD tenancy lighting assessment.

VII DEVELOPMENTS IN PRACTICE

i Tax Clearance Certificates for sale of properties now required

All real estate vendors must obtain a 'foreign resident capital gains withholding clearance certificate' (Tax Clearance Certificate) from the Australian Taxation Office (ATO) if the sale price is A$750,000 or more. Although the title indicates it applies to foreign residents, the requirement applies to Australian residents, in fact to all vendors. The term 'resident' means a resident for tax purposes.

The Tax Clearance Certificate is given to the purchaser on settlement of the sale, that is, when the price is paid. Without it the purchaser is under a legal obligation to withhold

12.5 per cent of the price and remit it to the ATO. The purpose is to protect the ATO's claim for capital gains tax payable on sale. Capital gains tax calculations are based on profit on sale, not a percentage of the sale price.

Australian resident vendors (for tax purposes) may apply for a Tax Clearance Certificate online, or in a paper form. Where there is more than one vendor, each vendor must lodge a separate application.

They are issued if the ATO is satisfied that the vendor has complied with their Australian tax obligations, that is, if a tax return has been filed within the past two years and there is no tax overdue. The ATO may issue a partial Tax Clearance Certificate to cover unpaid tax.

Foreign resident vendors may apply for a variation to reduce or eliminate the withholding obligation. They must prove to the ATO that they will make a capital loss on sale; or a capital gains tax roll-over applies; or they have carried forward losses or tax losses; or the proceeds of sale available at settlement are insufficient after repayment of the mortgage or other security interest; or they are selling their main residence (if before 30 June 2019).

ii Purchaser declarations for transfer duty

All purchasers must complete a declaration when buying or acquiring property in Australia. A new form was introduced on 1 July 2017.

Information collected through the purchaser or transferee declaration or statement is necessary to meet Commonwealth Reporting Requirements and to meet the Revenue Office's responsibilities to administer the Duties Act, including the identification of foreigners for purchaser surcharge duty and land tax.

The information collected includes:

a property details, including if it is residential or commercial, whether it is owner-occupied or an investment property;
b transactional information, including the transfer price, contact date and settlement date;
c identity information of the vendor or transferor and purchaser or transferee, including name, address, date of birth (for individuals) and Australian Company Number or Australian Business Number (for non-individuals);
d if the purchaser or transferee is the trustee of a trust, information about the trust; and
e nationality and immigration details of the vendor or transferor and purchaser or transferee.

The Commonwealth Reporting Requirements relate to foreign investment. The information is provided to the ATO for the purpose of information-matching and ensuring compliance with the taxation laws of the Commonwealth. The ATO can impose a 'vacancy fee' on residential real estate that is left unoccupied for more than 183 days per year.

The Duties Act requirements are directed to raising revenue. The information collected is used to identify whether a foreign purchaser surcharge is payable for transfer tax or stamp duties purposes. The information collected is also used for imposition of the annual land tax surcharge for foreign owners of residential real estate.

The land tax surcharge for foreign person ownership is 2 per cent in New South Wales. In both Victoria and Queensland, the surcharge is 1.5 per cent and is known an absentee owner surcharge (known as a 'ghost tax'), which is levied on unoccupied properties. For example, if land tax is levied at the rate of 1.6 per cent on the land value in New South Wales, then the surcharge will mean that land tax is levied at the rate of 3.6 per cent on residential land in foreign ownership.

iii Tax deductions for travel to visit investment real estate and some depreciation abolished

From 1 July 2017, the government has disallowed deductions for travel expenses related to inspecting, maintaining or collecting rent for a residential rental property. This was an integrity measure taken to address concerns that many taxpayers have been claiming travel deductions without correctly apportioning costs, or have claimed travel costs that were for private travel purposes.

Also from 1 July 2017, the government has limited plant and equipment depreciation deductions to outlays actually incurred by investors in residential real estate. Plant and equipment items are usually mechanical fixtures or those that can be 'easily' removed from a property such as dishwashers and ceiling fans. This was an integrity measure taken to address concerns that some plant and equipment items were being depreciated by successive investors in excess of their actual value.

VIII OUTLOOK AND CONCLUSIONS

The outlook and conclusions are well described in the extracts below from a paper presented by Jonathan Kearns (Head of Financial Stability, Reserve Bank of Australia) at a conference of Aus-China Property Developers, Investors & Financiers held at Sydney on 20 November 2017:

> *Purchases and financing by foreigner investors and banks have been prominent in the current commercial property cycle. We have seen this before and are well aware of the impact this can have on the cycle. The increased purchases of dwellings by foreign buyers, particularly for investment purposes, are a more recent phenomenon and so their impact on the housing cycle is less clear.*
>
> *Conditions in the housing market have eased, particularly in Sydney where prices had experienced strong growth and are particularly high, possibly giving lending restrictions greater impact in Sydney. In Melbourne, conditions remain stronger than in other capital cities. On the other side of the country, and at the other end of the spectrum in terms of housing market conditions, the Perth housing market remains weak. Prices have fallen gradually over the past two to three years, with rents also falling as the rental vacancy rate has increased to its highest level since 1990.*
>
> *Commercial office markets have been strongest in Sydney and Melbourne with low vacancy rates and rising prices. In contrast, conditions have been weaker in Perth where vacancy rates increased sharply with the downturn in the state economy from the decline in mining investment.*
>
> *Purchases by foreign buyers do not, on the whole, reduce the supply of dwellings available to local residents and in fact may actually contribute to expansion of the housing stock. Foreign buyers in Australia for work or study would have been renting if they did not purchase. Other foreign buyers rent the property as an investment and so contribute to the rental stock. Also, there are some new developments that only proceed because they get high pre-sales from foreign buyers.*
>
> *The strength of the Australian property market, and the participation by foreign buyers, has also enticed some foreign developers to Australia for specific projects, but overall they remain a small part of the market. Foreign banks also have a very small role in residential property lending in Australia.*

Chapter 4

AUSTRIA

Tibor Fabian and Markus Uitz[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

The term 'ownership' under Austrian laws signifies the full right to freely use the substance and the benefits of an asset and to exclude everyone else therefrom. There are qualitative grades of this full right of ownership. In particular, the following four types of rights to real estate thus seem to be interesting for investors.

i Ownership of real estate

Full ownership or freehold

In Austrian law, the principle *superficies solo cedit* applies, meaning that the owner of land is generally also the owner of any building thereon. The most common right to real estate is therefore to own both land and building. However, there are two major exceptions when talking about the *superficies solo cedit* principle: superstructures and building rights (as described under ('Superstructures') and ('Building rights') below).

Condominium ownership

A condominium right grants the co-owner of land the right to exclusively use an independent unit in a building. The condominium right is not created automatically; it needs to be established, mostly by a 'condominium agreement' signed by all co-owners and the registration in the land register. The owner of a condominium has free disposal of the allocated unit and can sell or encumber it without the agreement of the other co-owners.

Superstructures

Superstructures are buildings that are constructed on someone else's land with the intention of not remaining there permanently. Usually the developer acquires ownership of the superstructure through a 'superstructure agreement' with the owner of the land, granting the developer the right to erect the planned building as its owner. It is particularly remarkable that no registration in the land register for superstructures is necessary. In practice, superstructures mostly appear like permanent buildings, which is because of generous court rulings when it comes to the admissibility of creating superstructures.

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Building rights

A building right is the right to have a building on or beneath (e.g., underground parking garages) the ground surface on a third-party land. This right is granted for a limited period of time between 10 and 100 years. The most important difference to superstructures is the fact that building rights are to be registered in the land register.

ii System of registration

All land plots within the federal territory as well as the rights *in rem* associated with them have to be registered in a land register maintained by district courts. The land register consists of two parts, the main book (where all land-plot related rights and data are entered) and the document archive (where the documents on which the entries are based are registered). The main book contains four different sections (known as 'folios'):

a A1-Folio: This folio includes general data on the land plot, such as surface area and the type of use (e.g., agriculture or construction area).

b A2-Folio: This folio contains rights (e.g., easements) in conjunction with the specific land plot as well as restrictions imposed by public law.

c B-Folio: This folio contains information regarding the ownership in the land plot (e.g., the respective shares of each owner in case of co-ownership).

d C-Folio: This folio includes information about encumbrances connected with the plot of land, such as mortgages, possible building rights, sale restrictions and registered tenancy rights.

The land register is publicly accessible. The Austrian land register system follows both an 'intabulation principle' as well as a 'principle of trust' on registrations: On the one hand, the acquisition, transfer or deletion of *in rem* rights may only be accomplished by a registration in the land register (with certain exceptions such as acquisitive prescription) and, on the other hand, persons may generally rely on the correctness and completeness of registered facts and are legally protected in doing so (except for cases of bad faith) without them having to examine specific documentation in the document archive maintained by the district courts.

iii Choice of law

Pursuant to Regulation (EC) No. 593/2008 (Rome I), the parties are generally free to elect the law applicable to real estate transactions except for the respective *in rem* rights, which are always subject to Austrian law in case of properties located in Austria. To the extent that the law applicable to the contract has not been determined by the parties, Austrian law generally applies (as the law of the country where the property is located).

II OVERVIEW OF REAL ESTATE ACTIVITY

With rental prices significantly on the rise, the ongoing demographic trends and a demand exceeding the offer in most of Austria's urban areas, the Austrian residential real estate market sees an ongoing trend to affordable accommodation, including micro-living apartments and student houses. Residential rent has only increased moderately as compared to residential purchase prices (presumably at least partly owing to the Austrian Rental Act imposing caps on a large number of rented living space). As regards the commercial real estate market, modern office clusters outside of residential areas (but rather in proximity to other successful businesses) may increasingly be seen in Austria's major cities, in particular Vienna. Even though top locations remain strong with stable rents in retail real estate, shopping streets are generally affected by a decline in frequency. Yields on offices, retail and residential have hardened throughout 2017, a trend that seems to be persisting in 2018.

III FOREIGN INVESTMENT

Due to the generally stable political and economic framework, the demand for Austrian real estate is booming, fostered by extremely low interest rates and available financing. Even though real estate prices have increased significantly over the past years, Austria is still considered to be a place for non-speculative real estate investments, in particular as the demographic development and expected urban conurbation (with Vienna being constantly ranked as one of the world's best cities to live in) results in a situation where demand exceeds the offer. As a consequence, real estate investments appear attractive to foreign (institutional) investors. Nevertheless, local investors still account for a major part of the total Austrian real estate investment volume in 2017; international institutional investors and funds active in the Austrian real sector are responsible for most of the large real estate transactions.

The transfer of property rights to foreign investors may require an approval according to land transfer regulations. In this respect, each Austrian federal province has its own legal framework defining the applicable restrictions and approval process. As long as the necessary approval has not been obtained, the transfer of the ownership cannot be registered in the respective land register and the contemplated transaction may not be carried out (as ownership of real estate is generally only obtained by the registration of the new owner in the land register). Persons and corporate bodies of Member States of the European Union or of signatory parties to the agreement on the European Economic Area have the same status as domestic persons or corporate bodies.

IV STRUCTURING THE INVESTMENT

The structuring of the investment for the acquisition of a property should be based on various economic, fiscal and legal considerations, whereby investments may generally be structured as asset or share deals. The advantage of an asset deal is that the investor may be better aware of the transaction scope (in particular in relation to potential tax or other liabilities of a pre-existing company). A share deal would generally be tax advantageous since, with correct structuring, real estate transfer tax can be avoided. While an asset deal generally triggers Austrian real estate transfer tax of 3.5 per cent of the consideration, only a transfer of at least 95 per cent of the shares in a company holding Austrian real estate is subject to real estate transfer tax. Under this tax situation, it has become common practice to implement a share deal structure with two acquiring entities that each have to acquire more than 5 per cent in the target company (e.g., in a 94/6 per cent structure).

Further, a share deal will not result in a change in the ownership of the property itself, which means that registration fees of 1.1 per cent of the consideration or market value of the real estate may also be avoided. Three different legal forms are typically used as real estate holding entities and acquisition vehicles:

a The limited liability company (GmbH) offers flexibility and can be set up by one or more individuals as well as legal entities, which in general are not personally liable for the liabilities of the company. The minimum share capital amounts to €35,000, of which at least €17,500 has to be paid in. (Since 2014, there is an option to limit the share capital for up to 10 years to €10,000, of which at least €5,000 has to be contributed).

b The stock corporation is also a limited liability entity, where shareholders participate in the share capital divided into shares by means of contributions without being personally liable for the liabilities of the company. The minimum capital stock amounts to €70,000. The ongoing legal structure costs of a stock corporation are higher than for the limited liability company; in addition it offers less flexibility except in relation to share transfers and equity transactions.

c Partnerships may be established by at least two parties either as a general partnership or a limited partnership. The difference is the limitation of the liability of at least one partner in a limited partnership, while all partners of the general partnership are personally fully liable. Besides the flexibility of a partnership (which is even higher than in the limited liability company), the main advantage of the partnership is its tax transparency allowing a direct allocation of profits and losses to its partners for tax purposes.

V REAL ESTATE OWNERSHIP

i Planning

Austrian building law provisions, such as zoning laws and construction regulations, differ between each of the nine federal provinces (and in certain instances even the respective communities within these provinces), are quite strict and the approval process may have to be carried out under different authorities. The requirements for planning permission vary according to the envisaged location as every Austrian federal province has enacted its own building, planning and zoning laws. In some provinces a simple notification to the planning authority suffices for certain types of buildings, while in others a formal building permit has to be obtained in the course of an administrative procedure (which in some cases includes the participation of the direct neighbours). Additionally, federal laws have to be obeyed and permissions under these laws may have to be obtained (e.g., under heritage protection laws, air traffic safety laws, forest protection laws).

The protection and development of historic and cultural buildings is governed by the Austrian Heritage Law which is administered by the Federal Heritage Commission. Subsidiary rules might apply from provincial heritage laws, which differ between each of Austria's nine federal provinces. An existing heritage protection of real estate may generally be seen from the publicly available land register.

ii Environment

As a general rule, a 'polluter pays' principle is applying to environmental clean ups: whoever causes pollution is primarily responsible for the clean up and the associated cost. In certain instances, the owner of a polluted land plot and his or her legal successor may also be held liable in the second degree, mainly if they agreed to, or tolerated, the pollution.

No particular environmental disclosure obligations apply to real estate sales in Austria. Austrian case law assumes a fraudulent intent of the seller, however, if information was withheld to the potential purchaser that would otherwise typically be disclosed or could reasonably be expected to be disclosed in fair business dealings.

iii Tax

Typically, the following taxes could become payable in connection with real estate transactions.

Real estate transfer tax

The acquisition of Austrian real estate as well as the consolidation of more than 95 per cent of the shares in a company owning Austrian real estate in the hand of a single shareholder are generally subject to Austrian real estate transfer tax. The taxable base for the determination is the value of the consideration (i.e., as a rule the purchase price) or the true value of the real estate in case the purchase price is lower. The real estate transfer tax generally amounts to 3.5 per cent in case of an asset deal and to 0.5 per cent in case of the consolidation of more than 95 per cent of shares in a company. Also, transfers without consideration (donations) are subject to the real estate transfer tax under application of a progressive tax rate ranging from 0.5 to 3.5 per cent.

Real estate profit tax

The profit from the sale of the real estate is subject to a real estate profit tax, which is generally subject to a flat tax of 30 per cent provided that a flat tax rate of 25 per cent applies to all profits generated by profits from corporate entities (including from the sale of real estate).

Registration fees

In addition to the real estate transfer tax, a registration fee for entering the right of ownership in the land register amounting to 1.1 per cent of the consideration or market value of the property is incurred. For the registration of mortgages, an additional 1.2 per cent of the mortgage amount needs to be paid.

VAT

Real estate transactions are generally not subject to VAT. The selling party, if an entrepreneur, may opt to treat the sale of real estate as VAT taxable subject to a 20 per cent tax rate. An entrepreneur would typically take this option into consideration if it has reclaimed input tax within the past 10 years regarding the real estate (which would otherwise have to be refunded).

Stamp duties

The execution of a purchase agreement and the contemplated acquisition of real estate generally no longer triggers stamp duty.

iv Finance and security

Generally, real estate financing is provided by banks via loans. Restrictions on who may provide financing in relation to real estate transactions mainly stem from banking regulations that restrictively regulate the commercial granting of loans (including within groups). Typically mortgages serve as collateral for real estate financings. In case of share deals, pledges over the shares of the borrower, pledge of movables, accounts pledges, assignments of receivables or rights under any major contracts are also considered. To create a mortgage, pledgor and pledgee need to execute a mortgage agreement in writing with the signatures being notarised. Generally, both fixed amount mortgages (securing a specific amount) as well as maximum amount mortgages (which may be recurrently used under a specific relationship) are possible under Austrian law. The mortgage is only established upon its registration with the land register.

VI LEASES OF BUSINESS PREMISES

Austrian law generally differentiates between usufructuary leases (where an object is leased for use and profit) and tenancy agreements (where an object is leased for use) with different legal rules being applicable. Several conditions have to be met for the qualification as usufructuary leases (with the Austrian Supreme Court taking a strict view) so that the majority of business premises leases constitute tenancy agreements.

Tenancy agreements may be fully, partially, or not at all subject to the Austrian Rental Act, which contains several restrictions and a general legal framework applicable to lease agreements. The qualification depends on the type of lease and its purpose, its duration, and the building in which the premises are located.

Depending on the applicability of the Austrian Rental Act, the law could in particular provide for mandatory restrictions on the landlord's termination rights, the maximum amount of rent as well as the maintenance obligations. Within the scope of a partial applicability of the Austrian Rental Act, mainly termination restrictions regarding the lease agreement apply.

i Conclusion of lease agreements

There are no special formal requirements for the conclusion of lease agreements. Orally concluded lease agreements are also binding. Certain exceptions apply to agreeing on a fixed term for a tenancy agreement within the applicability of the Austrian Rental Act that need to be concluded in writing.

ii Term and termination

Generally, the term may be freely determined between the parties; lease agreements may thus be concluded for a fixed or indefinite period of time. Minimum periods only apply to residential leases within the scope of the Austrian Rental Act (minimum period of three years). Long-term and short-term tenants have the same rights under Austrian law without special extension or renewal rights applying to either of them.

Fixed-term leases terminate automatically upon the end of their term; indefinite lease agreements terminate upon their termination by either the landlord or the lessee after the lapse of the termination period (which depends on the qualification of the lease). Within the applicability of the Austrian Rental Act, a landlord may only terminate indefinite agreements for a limited number of legally specified reasons such as a detrimental use of the property by the lessee or defaults of the lessee in paying the rent.

An eviction of the lessee from the property is only possible after having obtained an appropriate legal title in the course of court proceedings.

iii Rent and adjustments

The rent may generally be freely determined by the parties except if the Austrian Rental Act is fully applicable. In the latter case, only an adequate rent (or even a legally capped rent) may be asked for by the landlord. The amount of an adequate rent or the legal cap is basically determined by the size, location and equipment of the premises.

In the event of (temporary) non-usability of the rented object, a tenant is entitled to (partially) withhold rent payments depending on the gravity of the defect.

In case of a sale of a business with a lease contract falling in the applicability of the Austrian Rental Act, the landlord is entitled to increase the rent to an adequate level within six months after having been notified of the transfer. The same principle applies in case of a change-of-control (e.g., as a consequence of a share deal).

iv Deposits

The Austrian Rental Act contains specific provisions on rent security deposits that apply to certain lease agreements. These rules include an obligation on the landlord to invest it in an interest bearing way if the deposit is delivered in cash (e.g., on a savings account). After the termination of the lease agreement, the landlord has to immediately return the deposit including the interest unless there are claims against the former tenant. Outside the applicability of the Austrian Rental Act, landlord and lessee may freely agree upon the conditions for rent security deposits. There is no legal cap on the rent security deposit. Typically, rent security deposits amounting to the rent of three to six months are asked for.

v Subletting

Subletting is allowed to the lessee unless contractually prohibited in the underlying lease agreement. In the case of subletting of the entire leased premise or for an unreasonably high sublease rent (as compared to the head lease rent and investment), each without the consent of the landlord, the landlord may terminate the lease agreement. The termination of the lease agreement automatically leads to the termination of the sublease agreement.

VII DEVELOPMENTS IN PRACTICE

The following developments in real estate law and practice throughout 2017 seem noteworthy.

Since the recovery from the real estate crisis began in 2009, prices have risen steadily. In Vienna, 2017 was another record-breaking year for investment in commercial real estate, despite an expected substantial drop in office rentals. New construction in 2017 has increased to 143,000 square metres, with three quarters of this space being pre-leased or owner-occupied or, if earmarked for the investment market, already sold by means of forward purchases.

The Austrian market, in particular, is dominated by about two dozen institutional investors, who buy and sell the top objects among themselves in considerable amounts and thus have an interest in keeping prices high. As a consequence, commercial real estate prices have risen another 9 per cent in 2017, and the amount of available real estate is decreasing. Of numerous projects being finished in 2018, most have already been sold; in 2019, less new commercial real estate will be available for investment than ever before. For all these reasons, the medium-term outlook for the real estate market remains good.

Further, due to the demographic development, an increase in development projects relating to students and elderly people are expected. As a consequence of housing shortages in urban areas and an increase of people living alone or in smaller group, the living space used per person has generally started to decline.

In the course of the acquisition of real estate, there is an increasing number of insurance products to provide protection against warranty risks and even environmental risks.

Major changes were enacted in the Non-Profit Housing Act with effect from 1 January 2016. In addition to new regulations in relation to the allocation of maintenance obligations and the introduction of a possibility to raise maintenance fees in a linear matter, renovation will become easier for the landlord. On the other hand, the new law will make it more difficult to sell objects due to the extension of the taxable period to 10 years and a pre-emption right for the building association.

There were attempts in 2017 to void the current system of capped rent and time limitations, in particular the fact that no location-related premiums may be requested from tenants in *Gründerzeit* quarters (i.e., certain buildings erected between 1870 and 1917), as unconstitutional. The Austrian Constitutional Court did not follow these arguments, however, so the current system remained in place.

The stamp duty for leasing residential premises has been abolished as of 11 November 2017. Until now, the stamp duty for residential premises (i.e., premises that are mainly used for residential purposes) amounted to 1 per cent of the gross rent for the total contractual period, limited to 1 per cent of the 36-fold monthly rent. This stamp duty has been abolished for lease agreements concluded from 11 November 2017. Written lease agreements for residential premises concluded prior to 11 November 2017, as well as other lease agreements (i.e., for commercial premises), remain subject to this stamp duty.

VIII OUTLOOK AND CONCLUSIONS

Political discussions about a reform of the Austrian Tenant Act and the general legal tenancy system will most likely continue in 2018 as during the past years. The main points of discussion in this context are a general cap on the rent, substantial decreases in the allowed rent for time limited lease agreements, a prohibition or at least a limitation on obligations for tenants to pay broker commissions as well as certain limitations for the landlord to pass on maintenance costs on tenants (e.g., real estate tax and insurance fees). A solution for these topics or even the (highly necessary) reform of the tenancy regime seems as unlikely to occur in 2018 as during the past years, although there is some hope that the newly formed coalition government will bring about some long-awaited changes by stakeholders in the real estate market.

Also, long-requested reforms in the administrative law and the abolishing of unnecessary legal and administrative barriers are most likely not to occur in the near future. Unless the new government keeps its promise to 'deregulate', real estate developments and construction projects will thus continue to face the same administrative burdens as today.

As a result, the Austrian real estate market is likely not to benefit from overall trends as could be possible in a more favourable environment. Given the general political and economic stability, however, investments and real estate prices are still expected to rise.

Chapter 5

BELGIUM

Yves Delacroix and Alexandre Emond[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

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 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 or planting right, which is a right to have buildings, works or plants totally or partly on, above or under 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 or co-ownership).

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 interests with 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 for other purposes (the Land Register is used for the calculation of real estate withholding tax).

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iii Choice of law

Belgian property law is essentially contained in the Belgian Civil Code. This 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 Belgian 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.

II OVERVIEW OF REAL ESTATE ACTIVITY

According to the National Bank of Belgium, the GDP growth rate for Belgium accelerated in 2017, reaching 1.6 per cent (compared to 1.2 per cent in 2016), and is expected to maintain more or less the same pace over the following two years (1.6 per cent in 2018 and 1.5 per cent in 2019).

Investments in Belgian commercial real estate have grown steadily. The further internationalisation of the investor base was consolidated in 2017, with Korean funds especially maintaining a strong interest in the Brussels office market in particular.

Until the end of the third quarter of 2017, according to JLL, investment volumes reached €2.4 billion, which is stable compared to 2016.

The office property market has returned to a more normal level of activity, with a take-up of 302,000 square metres for the first nine months of 2017 – 15 per cent lower than 2016, which was considered to be an excellent year. The full-year forecast is 350,000–375,000 square metres. In addition, vacancies decreased further to a 15-year low of 8.6 per cent in Brussels. However, it is expected that this vacancy rate will increase again as from 2018. With a total investment volume of €4,120 million at the beginning of December 2017, the investment market has reached its highest level since the beginning of the financial crisis.

Where 2016 was the year of the large-size deals, the normal flow of mid-sized corporate transactions (between 1,000 and 5,000 square metres) returned in 2017. It can also be marked as the year in which the trend of co-working spaces exploded.

Whereas diversification in 2016 referred to investment in various market segments (nursing or retirement homes as well as student housing next to more traditional markets such as office and residential), it appears that (international) investors in 2017 are diversifying by investing not only in the Brussels-Capital Region, but also in regional markets: besides traditional key regional markets Antwerp and Ghent, Leuven, Liège and Namur also came to the forefront with several transactions of more than 3,000 square metres.

III FOREIGN INVESTMENT

There are generally no legal restrictions on ownership or occupation by foreign entities. Neither are there, in principle, any restrictions 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, which can only be in favour of an EU-licensed credit institution. In this respect, 2018 will bring some new developments, with the entry into force on 1 January 2018 of the new legislation regarding securities on movable property. Among other things, this new legislation removes the restriction that the general pledge over the business can only be granted in favour of an EU-licensed credit institution.

IV STRUCTURING THE INVESTMENT

A very common structure to invest in real property is a direct purchase (asset deal). Many transactions, however, are conducted through company acquisition (share deal) because of, among others, 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 share deal (sale of shares of a company owning real estate) remains a common way to structure the investment. 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), no registration tax is due on the sale of shares. A share deal may produce a substantial saving on transfer tax for the purchaser, since the transfer tax due in the case of an asset deal is usually borne by the purchaser.

From a direct tax point of view, a transferred company continues to depreciate the real estate during the remaining depreciation period on the remaining depreciation basis because the property is not considered to have changed hands. A taxable capital gain is usually realised when the real estate is subsequently sold. The capital gain is equal to the difference between the sale price and the tax value of the real estate on the company's books, meaning the historical cost less depreciation (the sale price is usually higher than the tax value of the real estate on the books); hence, the parties usually take into account the tax latency for the valuation of the shares. 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, although the government has reached an agreement in principle to lower this to 29 per cent in 2018 and 25 per cent in 2020, which was approved in parliament on 22 December 2017. 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 recovered over the duration of the new depreciation.

Tax losses can be carried forward indefinitely; however, tax losses are barred in the case of a change of control that is not justified by legitimate financial or economic needs. 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.

As stated above, split sales structures are no longer an option for many investors; however, the granting of a 99-year emphyteotic right (long-term lease) can still be considered and is subject to a transfer tax of 2 per cent.

V REAL ESTATE OWNERSHIP

i Planning

Each region has enacted its own town and country planning code. In the Walloon Region, the Walloon Code of planning and zoning, urban development, heritage and energy has recently been replaced by the Walloon Territorial and Development Code. The Walloon Territorial and Development Code entered into force on 1 June 2017. In the Brussels Metropolitan Region, the Brussels Code of planning and zoning applies. A substantial reform of this code has been adopted. Most of the provisions entered into force on 1 January 2018. In the Flemish Region, planning and zoning regulations are governed by the Flemish Code of Planning and Zoning and a new Flemish Decree on the Unique Surroundings Permit. This new decree provides that both the building and environmental aspects are addressed in one single permit that is granted by one single authority.

In all three regions, every property falls within a particular zoning area, determined by the applicable zoning plans (regional zoning plans and municipal zoning plans). These plans must be taken into account whenever the competent authorities are dealing with an application for a building permit, but also when issuing any other permit.

Non-compliance with the applicable provisions of the zoning plan or permit requirements can trigger a variety of administrative, civil and criminal sanctions, depending on the date of the execution of the works at hand.

On 1 January 2018, a new Flemish Decree on the Integrated Retail Policy came into force. It allows Flemish municipalities to determine central retail areas with limited retail possibilities.

In the Walloon Region, socio-economic permits are issued by the municipalities or the Region, depending on various criteria, such as retail surface area. The Decree on Retail Premises also introduced an integrated permit that provides that all building, environmental and commercial aspects need to be addressed in this integrated permit.

ii Environment

All three regions have adopted a comprehensive set of rules relating to soil and groundwater contamination. The following common principles can be mentioned for the three regions:

a various events (transfer of land considered as presenting a risk, such as land where activities (included in a list of activities approved by the government) that can potentially cause soil pollution, are or were carried out (except for in the Walloon Region), accidental pollution or chance discovery of pollution, etc.) will trigger the obligation to conduct a preliminary soil survey;

b the regional public soil agency can request that a descriptive soil survey is filed if there are indications that the soil clean-up thresholds have been exceeded, or that the pollution is a serious threat to the environment and human health. The filing of the descriptive soil survey can give rise to the drafting of a risk management project or a soil clean-up project and, ultimately, to the execution of risk management measures or to the cleaning up of the land. Both the soil surveys and any soil clean-up project will require prior approval by the regional public waste agency; and

c in principle, the author of the contamination will be held liable for the pollution. However, the obligation to carry out a soil survey, and, if necessary, to remediate the soil, will rest upon the owner, user or operator of the site, unless they are exempted. If they have not caused the pollution, then they can later recover their costs from the author of the pollution.

Breaches of said regulations can also give rise to criminal sanctions.

iii Tax

The sale of real estate is subject to transfer tax at a rate of 12.5 per cent (if the property is located in the Walloon or Brussels Metropolitan Regions) or 10 per cent (if the property is located in the Flemish region). The transfer tax is calculated on the purchase price, which may include the charges imposed on the purchaser. However, if the fair market value is higher than the purchase price, the transfer tax will be calculated on the fair market value. Seller and purchaser are jointly liable to pay the transfer tax.

The sale of a new building may be subject to VAT at a rate of 21 per cent, in which case no transfer tax is due. If the seller is a professional builder, the new building is automatically sold with VAT. Any other seller wishing to sell a new building with VAT must opt to do so; this tax is due on the purchase price of the new building.

Transfer tax exemptions may be available if real estate is transferred within the framework of a transfer of an undertaking or within the framework of a reorganisation.

iv Finance and security

A standard security package required by third-party lenders generally consists of a mortgage or an irrevocable mortgage mandate.

In large transactions, the lender would also take security over other assets, such as a pledge over the receivables (rental income) or a business pledge (similar to a floating charge in the United Kingdom). In this regard, a new law of 11 July 2013 (which has entered into force on 1 January 2018) intends to allow pledges over movables without the formal requisite of dispossession, but by means of registration in the pledge register.

A mortgage deed must be signed before a notary public, the cost of which amounts to approximately 1.4 per cent of the mortgage amount. Therefore, 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 – in addition to the mortgage. Proxies to mortgage minimise costs but increase the risks for the lender.

In addition, certain lenders take *in rem* security rights over the entire business of the debtors by way of pledges. 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 retail 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, which apply by default insofar as specific legislation has not deviated from them.[2] The other types of lease agreements are governed by specific legislation in the Civil Code for instance the Retail Lease Act, of which most provisions are mandatory.

We will briefly review some of the general rules of the Civil Code and, when useful, make reference to or comparison with the Retail Lease Act.

i Term

Parties are free to agree on the term of leases. Written lease agreements concluded for a fixed term end automatically when the lease periods have expired, without prior notice (except as provided otherwise in the lease).[3] Leases may also provide early break options for one or both parties.

In the framework of the Retail Lease Act, a mandatory minimum term of nine years applies (although a recent amendment of the Retail Lease Act (see Section VII.i, below) has also made retail leases of one year possible in the Flemish Region); however, the tenant may terminate such a retail lease at the end of each three-year period, provided six months' prior notice is given. If the retail lease agreement explicitly allows so, the landlord may also terminate the lease at the end of each three-year period, if he or she wishes to carry on his or her own businesses in the leased premises, subject to a prior notice of at least one year. Parties may also terminate retail leases at any time upon mutual agreement, but such agreements must be notarised or 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. However, parties may explicitly stipulate that the rent will be linked to the cost of living (which is most common) or any other parameters and will be revised accordingly (upwards or downwards).

The Retail Lease Act stipulates the possibility for each party to request a revision of the rent at the end of each three-year period, provided the applicant can prove that the normal rental value of the premises has become at least 15 per cent higher or lower than the then applicable rent, because of new circumstances (the improvement of the district, etc.).

iii Renewal

The parties are free to provide a renewal 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).[4] 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:

2 Sections 1714 to 1762 *bis* of the Civil Code.

3 Section 1737 of the Civil Code.

4 Section 13 of the Retail Lease Act.

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 Retail Lease Act.[5]

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 towards tenants for damages in an amount of at least three years' rent.

VII DEVELOPMENTS IN PRACTICE

i Regionalisation of legislation regarding leases

Following the sixth state reform, the competence regarding residential and retail lease was (partially) assigned from the federal level to the regions (Flanders, Wallonia, Brussels Capital). The Flemish Region was the first to make use of its new competence and modified the Retail Lease Act in 2016 by adopting the Flemish decree regarding the retail lease of a short duration, more commonly known as the decree relating to pop-up stores. This decree, making it possible to enter into short-term retail leases for a duration of a maximum of one year (instead of the mandatory nine years provided in the Retail Lease Act) entered into force on 1 September 2016.

The Brussels Capital Region has also grasped this competence shift by adopting the Ordonnance of 27 July 2017 relating to residential lease. This Ordonnance entered into force on 1 January 2018. The novel approach of this Ordonnance is that the provisions relating to residential leases will be applied to all lease agreements for residential purposes: not only leases intended for main residence, but also leases regarding student residences and second residences will be subject to these provisions, save a few exceptions.

In addition, in order to address the omnipresent phenomenon of co-housing, this Ordonnance introduces the 'co-housing pact': co-housers will have the possibility to sign a co-housing pact between them, determining the responsibilities of each resident and the modalities when a co-houser leaves the residence. The pact will be attached to the lease agreement with the landlord.

Finally, this Ordonnance provides for the development of several useful instruments for tenants: a template lease agreement and inventory of fixtures, a list dividing the obligations (for example, regarding repair and maintenance of the leased premises) between landlord and tenant and an indicative table with rental prices per location.

These two items of regional legislation are most probably the beginning of a larger wave of regionalisation: in the Flemish Region, both retail and residential lease, have been

5 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).

the subject of draft decrees that are currently being discussed in parliament. The Brussels Capital Region and Walloon Region have followed the Flemish example and have adopted draft legislation regarding retail leases of a short duration. The Walloon Region adopted a draft decree relating to residential lease in September 2017, which is currently being reviewed by the Council of State.

ii Flemish decree integrated procedure for 'complex projects'

On 1 March 2015 the Flemish Decree of 25 April 2014 on complex projects in the construction industry entered into force.

Complex projects are defined as projects with significant social and spatial importance that require an integrated permit and zoning process.

The Decree sets out an integrated procedure that aims to allow the realisation of major infrastructure projects within an acceptable time frame and with a view to minimising the risk of inconsistencies entailed by several authorities having to grant various decisions or authorisations regarding one single (complex) project.

The procedure is optional for the developer, who is entitled to choose between the existing procedures and the new integrated procedure.

In general, this integrated procedure has not yet shown its capability to accelerate the decision-making process. Even though the integrated procedure has the potential to improve the quality of the process, the first pilot project did not prove to be very successful. It remains to be seen whether the aims of the integrated procedure can be achieved in future projects.

iii Anti-abuse provision: impact on past and current split-sale transactions

Until recently, the split-sale structure was a much used and very popular structure in Belgium for transferring control over immovable 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. The transfer tax due in connection with a long-term lease equals only 2 per cent of the amount paid under the long-term lease (compared with a transfer tax in the event of a transfer of the encumbered ownership amounting to 10 or 12.5 per cent, depending on the location of the property). The Act of 29 March 2012 introduced a general anti-abuse provision into Belgian tax law which 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.

The Belgian ruling commission[6] no longer issues advance rulings on split sales involving related parties.

However, the Belgian ruling commission agrees to issue advance rulings on the termination of split sales carried out under the previous anti-abuse provision. Indeed, the Belgian ruling commission issued numerous rulings on the tax treatment of the reconstitution of the full ownership where the application of a transfer tax of 2 per cent, in respect of the acquisition of the long-term lease, and a transfer tax of 10 per cent or 12.5 per cent

6 With regard to real estate transactions in Flanders, the Belgian ruling commission no longer has competence to issue rulings. A new regionalised ruling administration has been created. This is the consequence of the decentralisation of competence for tax from the federal level to the regions. Since 14 August 2015 (following the Decree of 17 July 2015) advance rulings can also be requested from the Flemish tax authority.

(depending on where the property is located), in respect of the acquisition of the encumbered ownership is confirmed. Such an advanced tax ruling on the ownership reconstitution will, however, only be issued on the condition that the buyer is not affiliated to the sellers of the long-term lease right and the encumbered ownership.

With regard to split-sales, the Flemish tax authority (Vlabel) has issued stringent viewpoints regarding the reconstitution. According to these viewpoints, the reconstitution of the full ownership (even in the hands of a third party) will, in any case, trigger a 10 per cent transfer tax on the whole property. These standpoints are not in line with the stance taken by the Belgian ruling commission and both are heavily debated owing to the legal uncertainty they have created. These viewpoints lead to a different treatment of the reconstitution of the full ownership in the three regions: in the Walloon Region and the Brussels Metropolitan Region, the reconstitution could be subject to 12.5 per cent on the transfer of the encumbered ownership and 2 per cent on the transfer of the long-term lease whereas the reconstitution in the Flemish Region, according to the Flemish tax authority, triggers, in any case, a transfer tax of 10 per cent on the whole.

iv Regulated real estate company (SIR/GIV)

Alongside the Belgian real estate funds regime, the Act of 12 May 2014 on Regulated Real Estate Companies and its implementing Royal Decree of 13 July 2014 created the regulated real estate company (SIR/GVV). This specific 'real estate' company is not caught by the AIFMD regulations.

A SIR/GVV must carry out its own operational activities and may not own real estate assets other than land and buildings in excess of a certain percentage of its total assets.

The main characteristics of the SIR/GVV status can be summarised as follows:

a at least 30 per cent of the SIR/GVV shares must be admitted to trading on a regulated market;
b the SIR/GVV is subject to the supervision of the Belgian financial market supervisor;
c the corporate governance structure of the SIR/GVV is strictly regulated by the SIR/GVV Act as well as its debt ratio, that cannot exceed 65 per cent of its consolidated assets;
d the SIR/GVV is compelled to distribute 80 per cent of its profits on an annual basis; and
e the SIR/GVV possibility to enter into partnerships or to create joint ventures is also strictly regulated by the SIR/GVV Act.

From a tax point of view, the SIR/GVV is liable to corporate income tax at a rate of 33.99 per cent, although only on a very limited tax base. Capital gains and recurrent income from property, therefore, are not subject to tax.

Public real estate companies opting for SIR/GVV status are subject to an exit tax amounting to 16.995 per cent of the unrealised capital gains on their assets and untaxed reserves.

From a Belgian perspective, the SIR/GVV benefits from the provisions of double taxation treaties because it is subject to Belgian corporate income tax.

As of 1 January 2017, dividends distributed by a SIR/GVV are subject to a 30 per cent withholding tax except for the SIR/GVV of which the real estate portfolio is composed of at least 60 per cent of real estates located in the EEA and exclusively or mainly dedicated to care and housing units benefit from a 15 per cent withholding tax. The Belgian government has announced that investors in a SIR/GVV would benefit in the near future from all withholding tax exemptions foreseen by Belgian law (such as the exemption for dividends received by a European company that owns 10 per cent of the SIR/GVV, the exemption for dividends received by pension funds, etc.). If no exemptions apply, the withholding tax is the final tax for non-resident investors and resident individual investors. However, non-resident investors can apply for reduced withholding tax under an applicable tax treaty.

For resident corporate investors, dividends distributed by a SIR/GVV cannot benefit from the participation exemption and, as a rule, will be taxable at a rate of 33.99 per cent. Capital gains realised by resident corporate investors on shares in a SIR/GVV are fully taxable; capital losses are not tax deductible.

v New specialised real estate investment fund

To meet the needs of professional and institutional investors looking for real estate investments with a limited term, and in contrast to the SIR/GVV, which remains long-term oriented, a new type of fund has been created by the Royal Decree of 9 November 2016: the Specialised Real Estate Investment Fund (FIIS/GVBF). The FIIS/GVBF is dedicated to institutional and professional investors and large corporate actors and aimed at facilitating real estate investments in Belgium and abroad.

The FIIS/GVBF status is available to institutional closed-end investment companies (but not to contractual funds) subject to AIFMD provisions, subject to certain exemptions (e.g., entities held by a single investor or entities exempted from AIFMD provisions as referred to in Article 2.3 of the AIFMD are allowed to opt for the FIIS/GVBF status).

The FIIS/GVBF status requires a mere registration with the Federal Public Finance Service and is granted for a maximum duration of 10 years, with the option to extend for further five-year periods.

The FIIS/GVBF can invest in various types of real estate assets, save for limited restrictions (e.g., requirement that the properties located in Belgium be directly held by the FIIS/GVBF, minimum value of real estate assets of €10 million, interdiction to act as real estate developer). The FIIS/GVBF is not subject to certain regulatory restrictions applying to other types of funds (e.g., no requirement with respect to diversification – i.e., the FIIS/GVBF may hold a single real estate asset – or debt ratio, but at least 80 per cent of net profits must be distributed).

From a tax point of view, the regime governing the FIIS/GVBF aims at being particularly attractive: opting for the FIIS/GVBF status triggers the payment of an 'exit tax' of 16.995 per cent and the tax regime is for the remainder identical to that applying to existing SICAFIs and SIR/GVVs.

As of 11 December 2017, 10 FIIS/GVBF were registered in Belgium.

VIII OUTLOOK AND CONCLUSIONS

Internationalisation of the investor base and diversification of investment products is increasing in the Belgian real estate market.

Legislation regarding real estate has only known piecemeal changes over the last few years. This might change in the (near) future: on the one hand, the further regionalisation of the legislation regarding leases (as set out above) can be expected. On the other hand, following the Minister of Justice's policy letter of 6 December 2016, in which he announced an important reform of real estate legislation, a detailed and comprehensive proposal of new real estate legislation was subjected to public consultation on 7 December 2017. The proposal constitutes a far-reaching reform of legislation that has remained largely unchanged since the 19th century. The proposal is aimed at rendering the rights *in rem* more apt for large-scale modern transactions, while at the same time leaving a large amount of flexibility for the parties.

Chapter 6

BOSNIA AND HERZEGOVINA

Indir Osmić and Ana Terzić[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

Bosnia and Herzegovina (BiH) consists of two main territorial and administrative entities: the Federation of Bosnia and Herzegovina (FBiH) and the Republic of Srpska (RS), as well as the small Brčko District that is under sovereignty of BiH. Legislation related to natural and legal persons and real estate matters is mostly enacted at the entity level, provided that Brčko District also has its own laws and rules concerning real estate. Our review, unless it is specifically stated otherwise, is related to the entities as they jointly cover more than 96 per cent of the BiH territory.

i Ownership of real estate

Ownership, as the right to property, is the most comprehensive right a person or legal entity can hold in relation to a certain property and it is protected by the Constitution of BiH (i.e., by Article 2 of the Constitution, which stipulates that the European Convention for the Protection of Human Rights and Fundamental Freedoms and its Protocols are applicable directly). The right of ownership is defined as a property right (right *in rem*) on a particular object, authorising the holder to possess, dispose or use the object and any benefits arising from it as he or she sees fit, and to exclude any other person from it, unless that is contrary to the other person's right or limitations imposed by the law.

The right of ownership is acquired on the basis of legal transaction, law, court or other relevant authority decision, by fulfilling the conditions prescribed by the applicable law.

Acquisition of ownership over real estate is subject to registration of ownership at the competent Land Registry.

Where more than one person has ownership over a single property, they will hold their interest as follows:

a co-ownership – each of the owners has a defined share over the property, which is determined as a part of the overall object. Each of the co-owners is entitled to dispose freely of his co-ownership part;

b joint ownership – the shares of the joint owners are not determined. All owners dispose of the object (being jointly owned) together. This type of ownership can only occur on the basis of the law; or

c condominium – a specific type of ownership over real estate, characteristic of apartments or residential buildings. Co-owners of a property may agree to limit their co-owner's rights by connecting the ownership of a particular part of the property (apartment) to

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their co-ownership share of the co-owned real property. In this case, a person is the sole owner of the relevant apartment, while the common space and the ground below the building are under the co-ownership right of all residents in the building.

Co-owners of one of the flats, business premises or independent facilities generally have a priority purchase right, except for condominium ownership.

ii System of registration

All property rights (rights *in rem*) over real estate (and some obligations, such as pre-emption right, lease, construction and concession) are registered at the relevant authority. It is important to note that there are two different systems of registration depending of the entity where the real estate is located. In the FBiH there is still a dual system of registration whereby ownership rights are registered in the land registry department of the competent court, while the possession right is registered in the cadastre office of the relevant municipality. In the RS, after the recent reform, all rights over the real estate are registered in the relevant office of the Republic Administration for Geodetic and Property Affairs (RUGIP).

The registration procedure is initiated by means of a written request for registration, together with the original documentation that is the legal basis for the request for registration, usually a purchase agreement concluded in the form of a notary deed. If the request is complete, the registration occurs on the basis of a decree on registration, which is issued by the relevant land registry authority.

Other forms of registration in the competent land registry are pre-registration (to have registration effect, pre-registration has to be subsequently justified) and remark (has a public purpose of evidencing some circumstances in connection with the real estate transactions).

iii Choice of law

The following laws apply in respect of choice-of-law matters and are applicable regarding transactions including real estate:

a the Law on Property Rights of the FBiH (Official Gazette of FBiH, Nos. 66/13 and 100/13);
b the Law on Property Rights of the RS (Official Gazette of RS, Nos. 124/08, 3/09, 58/09, 95/11 and 60/15);
c the Law on Construction Land of the FBiH (Official Gazette of FBiH, Nos. 67/05);
d the Law on Spatial Planning and Use of Land of the FBiH (Official Gazette of FBiH, Nos, 2/06, 72/07, 32/08, 4/10, 13/10 and 45/10);
e the Law on Spatial planning and construction of the RS (Official Gazette of RS, Nos. 40/13, 106/15 and 3/16).
f the Law on Construction Land of the RS (Official Gazette of RS, Nos. 112/06, 38/11 and 40/13);
g the Law on Public Private Partnership of the RS (Official Gazette of RS, Nos. 59/09 and 63/11);
h the Law on Business Entities of the FBiH (Official Gazette of FBiH, No. 81/15) (the FBiH Company Law);
i the Law on Business Entities of the RS (Official Gazette of RS, Nos. 127/08, 58/09, 100/11 and 67/13) (the RS Company Law);
j the Law on Registration of Business Entities of the FBiH (Official Gazette of FBiH, Nos. 27/05, 68/05, 43/09 and 63/14);

k the Law on Registration of Business Entities of the RS (Official Gazette of RS, No. 67/13 and 15/16);
l the Law on Policy on Direct Foreign Investment of the BiH (Official Gazette of BiH), Nos. 4/98, 17/98, 13/03, 48/10 and 22/15);
m the Law on Corporate Income Tax of the RS (Official Gazette of the RS, No. 94/15 and 1/17);
n the Law on Corporate Income Tax of the FBiH (Official Gazette of the FBiH, Nos. 15/16); and
o the Law on VAT of the BiH (Official Gazette of the BiH, Nos. 09/05, 35/05, 100/08 and 33/17).

II OVERVIEW OF REAL ESTATE ACTIVITY

Recently, the sector showing the most activity in the real estate investment market has been the road construction sector (e.g., construction of the tunnels and bypasses on major intercity roads, and in particular Zenica and Sarajevo, construction of the motorway on Pan-European Corridor Vc in the FBiH and construction of a motorway between Banja Luka and Doboj in RS). These projects are financed mostly from international development banks (e.g., EBRD, EIB and similar) through various financing arrangements. At this time, more than 100km of motorway on Corridor Vc has been constructed in the FBiH, which is one-third of the whole project. New sections of the motorway, in particular the southern section of the corridor and the city of Zenica bypass, are expected to be constructed or finished in the near future.

Furthermore, there is a significant increase in the residential and hotel buildings construction sector, with a focus on the Sarajevo market, where several investors from Gulf states are investing in construction of residential resorts and hotels around Sarajevo. It should be noted that a new upscale brand hotel has been opened in the natural zone close to Sarajevo. Moreover, the tourism sector in the BiH is experiencing huge increases every year, which are followed by investment in various tourism facilities.

There is also considerable interest in the construction of energy facilities. Several thermal and hydropower plants are in the process of construction or pre-construction, and international and Chinese financial institutions have expressed interest in financing such projects. One of the biggest upcoming projects in this sector is the construction of Block 7 of the thermal power plant in Tuzla, while a new thermal power plant has also been planned in Banovici, a small town in north-eastern BiH. As for the energy sector, several wind-power parks have also commenced construction.

In addition, a huge increase in energy efficiency projects and developments in this area should be noted for this and years to come.

III FOREIGN INVESTMENT

The Law on the Policy of Foreign Direct Investment, in force since 1998, ensures the national treatment of foreign investors (i.e., foreign investors have the same rights and obligations as those defined for domestic investors).

In addition, the rights and benefits granted to foreign investors, and obligations imposed by the Law, cannot be terminated or overruled by laws and regulations passed subsequently.

If any laws and regulations passed subsequently are more favourable to foreign investors, the investors have the right to choose which regime should govern the foreign investment concerned.

Foreign investors are entitled to open accounts in any commercial bank in domestic or any currency freely convertible on the territory of BiH and to transfer abroad, freely and without delay, in freely convertible currency, any proceeds resulting from their investment in the BiH.

Foreign investors are entitled to freely employ foreign nationals without any restrictions on the management of companies with foreign capital, subject to the labour and immigration laws in the BiH.

Foreign investors shall not be subject to any act of nationalisation, expropriation, requisition or measures having similar effects; such measures may take place only in the public interest in accordance with the applicable laws and regulations and against the payment of an appropriate compensation (i.e., compensation that is adequate, effective and prompt).

Foreign investors may own real estate in the BiH and have the same property rights with respect to real estate as any legal entity of the BiH. However, reciprocity rules should be taken into account.

Foreign direct investments are generally exempted from customs and custom duties, unless otherwise prescribed by the applicable provisions of the Law on Customs Policy of the BiH.

IV STRUCTURING THE INVESTMENT

According to the applicable laws in the BiH, foreign natural or legal persons may acquire real estate in the BiH upon registering as a foreign investor in the register of foreign investment maintained by the Ministry of Foreign Trade and Economic Relations.

Based on the Law on Policy on Direct Foreign Investment, the foreign investor may be registered in the register of foreign investment upon investing in the BiH through (1) establishing a local company as a sole shareholder, (2) establishing a local company with a local natural or legal person, or (3) investing in an existing local company.

Therefore, for a foreign person to purchase real estate in the BiH, it has to invest in the BiH in one of the above-mentioned ways.

In addition, it should be noted that foreign persons may acquire property if there is reciprocity established between the BiH and his or her country of origin. However, property rights rules provide additional limitations that may be imposed on the foreign persons, whereby it stipulates that real estate that is important for the protection of national interests and security under the statute cannot be acquired by the foreign persons.

Nevertheless, it is important to emphasise that foreign persons can acquire the property through inheritance, except in cases where the law or international agreements provide otherwise.

The most efficient way of structuring the transaction would be through the establishment of a local legal company that can freely act as a buyer in the domestic real estate market or through the acquisition of a local legal company that is the owner of a specific property.

V REAL ESTATE OWNERSHIP

i Planning

In the BiH, the construction of a building requires an urban permit, a construction permit and a use permit.

The urban permit is actually a 'planning' permit confirming what the owner may build on its land. It is issued in accordance with spatial planning documents.

The construction permit is more of a technical permit confirming how the owner will and may construct an approved object. At the moment of issuance of this permit, the petitioner has to prove its interest in the developed property (usually by providing a land registry excerpt as proof of registered ownership or construction right).

The issuing authority has statutory periods within which a decision must be made as to whether or not the above permits should be issued. There are various statutory rights in relation to appeals, which can be exercised if an application is refused or not resolved in a timely fashion.

The use of a building requires a separate permit – the use permit. The permit is issued after the technical acceptance of the constructed building has been performed. The use permit represents a final confirmation that the building has been constructed pursuant to the issued permits and other regulations and that the building is ready for use.

Additional consents for operation of a property might be required, depending on the nature of activities and operations to be performed on such a property. For example, energy production facilities will require additional consents and permits that are issued by the competent regulatory bodies.

ii Environment

By tradition, the primary environmental consideration has been potential soil and groundwater contamination as a result of current and former uses. In recent years, this consideration has been extended to include air quality, nature and plant life, mineral resources research and energy efficiency requirements for the buildings.

Consequently, the laws stipulate obligation to remedy contamination and to undertake measures to prevent harm from occurring to people and nature.

In principle, legal responsibility follows the 'polluter pays' principle (i.e., the person who spilled, released or discharged the offending substance will normally be liable to remedy damage caused to the environment). If the owner of a property fails to comply with this statutory obligation, the relevant authorities may enforce payment of damages through various administrative and court procedures.

It should be noted that having in mind high statutory penalties for non-compliance, environmental due diligence is becoming usual. Additionally, certain types of construction project will require the owner and future investor to prepare an environmental impact study before proceeding with the planned construction. Anyhow, the building process generally dictates that certain environmental consents and permits are necessary in order to obtain construction-related permits.

iii Tax

In the event of the sale and purchase of real estate, the following taxes can apply: real estate transfer tax (RETT) in the FBiH, real estate tax (RET) in the RS and value added tax (VAT).

Current situation

RETT at the rate of 5 per cent (average) is payable on the transfer of land (including contributions). The taxpayer is the party acquiring the real estate. The base for the real estate transfer tax is the property's market value at the time of execution of the underlying agreement, while in case of exchange tax base is generally the price difference between two properties. The tax authority usually assesses the market value of the property if the total price is lower than the market price at the moment of acquisition of the real estate or the signing of the underlying sale and purchase agreement. The application for taxation must be submitted to the competent tax authority office (the tax authority where the real estate is situated) within 15 days of execution of the underlying agreement. Default in payment triggers statutory penalty interest. The payment of RETT is a precondition for registration of title at the Land Registry.

As emphasised above, there is no RETT in the RS, but rather an annual property tax in the amount of 0.10 per cent to 0.20 per cent of the estimated value of the property. The RS Tax Authority has a fiscal registry of real estate where tax payments and obligations for each property are recorded.

In addition, VAT – at the current rate of 17 per cent – is payable upon the sale of 'new' buildings or apartments (newly constructed buildings – objects that were not used or exploited prior to the sale).

Because of the prohibition on double taxation, when the property sale is subject to VAT, RETT is not paid.

The VAT is paid by the party acquiring real estate simultaneously with the purchase price for the property being acquired.

Furthermore, lease of real estate is also subject to VAT, except leases and subleases of residential premises, apartments and housing projects where the lease is for a period of more than 60 days, as well as the services involved in leasing agricultural land and forests registered in the land books.

In addition, it is important to note that income generated from real estate may be subject to other direct taxes such as personal or corporate income tax and property taxes, where the last are usually based and levied pursuant to legislation adopted at the lower administrative levels such as the cantons in FBiH.

The corporate income tax laws generally provide that income associated with the local immovable is subject to corporate income and/or withholding tax, provided that certain tax incentives are prescribed for investments into the real estate that will be used for performance of the tax payer's business activity.

As for the other fees, generally each party pays its own expenses and costs. The buyer will usually be responsible for the payment of the land registry fees associated with registration of the transfer.

iv Finance and security

The most common form of security granted over real estate in the BiH is a mortgage. In addition, the Law on Property Rights of the FBiH provides for additional security instruments related to real estate such as a land charge. A land charge is a limited property right established on the real estate, with the effect that a certain amount of money from the value of the real estate is paid to the person who is the holder of this right, and the owner of the real estate is obliged to tolerate such encumbrance. However, this type of security is not yet common in practice.

VI LEASES OF BUSINESS PREMISES

i Applicable law

The lease of retail premises is governed by the Bosnia and Herzegovina Law on the Lease of Business Buildings and Premises (LLBP), which is in force in both the RS and the FBiH, and the Obligation Act.

The LLBP is a *lex specialis*, while the Obligation Act is a *lex generalis*. As a consequence of this, the provisions of the LLBP prevail given that the provisions of a special law derogate from the provisions of a general law.

In the FBiH some cantons have adopted a separate LLBP that imposes further regulations on such leases.

For business leases there are additional rules established by municipal bodies. These provide for additional obligations on the contracting parties, to be included into lease agreements.

ii Duration

There are no minimum or maximum durations of leases. Leases can, therefore, be granted for a limited or an unlimited period, but usually the term varies from one to five years. It is also standard practice for a renewal provision to be included in a lease agreement.

iii Early termination by the landlord

According to the LLBP, the landlord may withdraw from the lease agreement at any time, regardless of the contractual or legal provisions in that respect if:

a the tenant continuously uses the premises in a manner that is contrary to the lease agreement or causes considerable damage to it, without necessary diligence, after receipt of a formal notice to remedy sent by the landlord; or

b the tenant does not pay the rent within a period of two months after receipt of a formal notice sent by the landlord.

In the event of early termination, the landlord is obliged to deliver a written statement to the tenant determining the date on which the premises must be handed over to the landlord (at least 30 days). If the tenant does not hand over the premises within the aforementioned time, the landlord may request the judicial handover of the premises.

In addition, a lease agreement concluded for indefinite period can be terminated by mutual agreement of the parties, by a notice of termination or by withdrawal from the lease agreement.

Termination of the lease agreement by a notice of termination can be completed only upon expiry of a one-year period starting from the establishment of the lease.

A lease agreement concluded for a definite period can be terminated upon expiry of the period for which the lease agreement was concluded or by withdrawal from the lease agreement.

Notice of termination of the lease agreement is effective from the day the notice of termination is delivered to the other party. The period of notice of termination is determined by the lease agreement or by the law (the termination period).

The termination period elapses only upon the first or 15th day of the month, unless otherwise regulated by the lease agreement. Also, the termination period is six months, unless otherwise regulated by the lease agreement.

The procedure for termination of a lease agreement should be initiated through the competent court and in accordance with the procedure prescribed by the LLBP. Upon receiving the termination notice, the court is obligated to issue the court order to the tenant if it finds that the termination of the lease agreement is justified.

iv Early termination by the tenant

According to the LLBP, the tenant may withdraw from the lease agreement at any time, regardless of the contractual or legal provisions in that respect, if the landlord, after receiving a formal and reasonable notice to remedy, does not provide the premises in a condition suitable for their use.

In addition and as indicated above, lease agreements concluded for an indefinite period can be terminated by mutual agreement of the parties or by a unilateral termination. A lease agreement concluded for an indefinite period can be terminated by unilateral termination upon the expiry of a one-year period starting from the establishment of the lease.

v Right of renewal and eviction indemnity

It is common practice in the BiH to include a renewal provision in retail lease agreements.

According to the LLBP, if the lease agreement is concluded for a fixed term and provided that the landlord does not oppose the prorogation of the lease, the tenant has the right to continue the occupancy of the premises. The landlord will be considered as accepting the prorogation of the lease if the latter does not send a termination notice to the court within 15 days of the expiration of the lease.

There is no eviction indemnity payable by the landlord unless otherwise agreed in the contract.

vi Fitting-out works obligations

In most retail lease agreements, the right for the tenant to alter or improve the premises is limited. Structural alterations are frequently prohibited and non-structural alterations usually require the landlord's prior consent.

With the consent of the landlord, the tenant can execute, at his or her own expense, all improvements useful for the proper functioning of the premises. If such improvements cannot be removed from the premises, the tenant may claim compensation for said improvements or for a reduction of the rent during a certain period.

At the end of the lease, the tenant is obliged to return the premises either in the condition agreed with the landlord, or in the original condition.

In addition, the landlord may require the removal of any alteration. If the said alteration to the property remains in place, the tenant will have to pay compensation to the landlord.

vii Reinstatement of the premises

The tenant is not responsible for alterations of the premises that are caused by normal wear and tear. For any other damage, the tenant is obliged to repair the premises at its own cost.

viii Sublease and transfer of the lease

The tenant cannot partially or totally sublease the premises, without the express consent of the landlord. In such cases, the tenant has to guarantee that the subtenant will comply with the destination of the premises as agreed in the lease agreement. In addition, the Obligation Act provides that the landlord is entitled to settle obligations of a tenant (usually rent and charges that are not paid on time) against a subtenant.

The express consent of the landlord is also required for the transfer of the lease.

ix Acquisition of the premises

If the landlord sells the premises, the lease agreement is not terminated. All rights and obligations towards the tenant are automatically transferred to the new owner. However, if a forced sale of the premises is initiated to settle creditors' claims, the lease will not be transferred to the new owner, unless the lease agreement is registered with the Land Registry, which protects the tenant against eviction by the new owner.

x Pre-emption right for the tenant

The tenant has no pre-emption right in the event of the sale of the premises unless otherwise agreed in the lease agreement.

xi Rental guarantee

There are no mandatory provisions regarding the form or duration of a rental guarantee. Usually, the landlord requires a security for the payment of a rent and the amount varies between three and six months of rent.

xii Maintenance and repair

The landlord is responsible for the major repair and maintenance of the common areas and the structure of the building (such as structure or heating systems).

The tenant is responsible for all operating costs, minor repairs and maintenance of the interiors of the premises linked to the use of the premises.

xiii VAT

The rent and service charges are subject to VAT at a rate of 17 per cent, with certain exceptions noted above.

VII DEVELOPMENTS IN PRACTICE

In recent years, both entities are very active in reforms with a goal to create a better business environment. Consequently, both entities have adopted new labour laws and corporate income tax laws based on OECD recommendations.

In the RS a new one-stop shop registration system was introduced few years ago, while the government in the FBiH also has similar plans on this matter. The general aim of these reforms is to reduce time for registration of business and obtainment of construction related permits with an aim to attract more foreign investors.

At the same time, the authorities are continuously adopting new rules for the banking sector that would provide less complex requirements for the banks in regard to financing arrangements.The governments are also working on new laws related to the personal income, customs and VAT in order to harmonise the legislation with the available international standards and practices. It should be emphasised that the public private partnership legislation is also subject to reforms.

In addition, in the recent period the NPL (nonperforming loan) market is booming, whereby in practice the most attractive NPLs are seen as the ones secured by the mortgage over real estate.

VIII OUTLOOK AND CONCLUSIONS

The central BiH institutions are making significant steps toward EU accession. In this process, rules and policies related to business sector are expected to be updated and improved in accordance with the EU standards. As part of that process BiH has signed the Stabilisation and Association Agreement, which provisions are generally implemented in practice.

Moreover, the BiH is currently in the negotiation process for World Trade Organization membership and signed the Central European Free Trade Agreement in 2006, creating a free trade zone with access to a large regional consumer market.

The ongoing economic reform process supported by the World Bank group has contributed significantly to a greatly improved business climate in both the FBiH and the RS.

Notwithstanding the above, it is still necessary to work on internal harmonisation of rules and practice between the entities, and also with the EU *acquis* in order to make the BiH an attractive market for foreign investors.

As emphasised above, the country is expecting significant public projects, such as construction of motorways, energy facilities and investments in the tourism business.

Chapter 7

BULGARIA

Katerina Kraeva and Atanas Mihaylov[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

Under Bulgarian law, the ownership right over real estate gives the owner the exclusive right to occupy, dispose and use the respective real estate. There could be exclusive ownership rights over:

a land plots;
b buildings and parts of buildings; and
c facilities constructed on, above or below the land (e.g., electric power lines, gas pipelines, water pipelines, etc.).

It is possible to acquire ownership over a building or part of building, or over a facility without acquiring the ownership over the land plot on which the building or the facility is constructed. Thus, different persons can own the land plot and the buildings or facilities constructed on the land plot.

The Act on Ownership allows the ownership right to belong jointly to two or more persons, where each of these co-owners holds a share in the ownership right. The co-owners may terminate the co-ownership over the real estate at any time by a partition agreement (with notary certified signature of the parties), by the virtue of which each co-owner will cease to own a share in the ownership right but will acquire an exclusive ownership over a separate physical part of the real estate. In the partition agreement, the co-owners will settle any differences between the value of the share in the joint ownership right before the partition and the value of exclusive ownership right over a physical part of the real estate in cash. If the co-owners cannot reach an agreement for the partition, each co-owner may request partition from the court. In such case, the court will implement the partition through a court ruling.

In terms of ownership over buildings, the Act on Ownership provides that the owners of different parts of building (apartments, studios, shops, etc.) could have a joint ownership over those parts in the building that are common for all owners, such as the courtyard, foundations, external walls, staircases, roof, elevators and others (condominium ownership). Unlike the usual joint ownership, the owners may not partition the condominium ownership.

Ownership rights over real estate are freely transferable, although in certain cases there could be pre-emption rights of third persons, such as:

a a co-owner of a real estate is entitled by law to a pre-emption right to acquire the shares in the ownership rights held by other co-owners; or

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b the owner of a land plot is entitled by law to a pre-emption right to acquire the ownership right over a building on that plot if another person owns the building.

Bulgarian law also recognises limited property rights over real estate owned by another person (i.e., the holder of the limited property right over the real estate is different from the owner of the real estate). Such limited property rights include the right to construct over a land plot (i.e., the right to construct and own a building in other person's land plot), the right to use real estate (i.e., the right to use other person's land plot) or the easement right over land plot (e.g., the right to pass through other person's land plot).

In general, most transactions involving real estate (e.g., transfer of ownership over real estate, establishment or transfer of limited property rights over real estate) should be in the form of a notary deed executed before a registered notary. Certain transactions with real estate (e.g., partition of jointly owned property, establishment of easement rights) require notary certification of signatures. Upon execution of the notary deed or the notary certification of signatures, the notary should register the transaction in the real estate register of the respective registry agency office at the location of the real estate in order to protect the ownership title of the acquirer against third parties.

A notary deed or notary certification of signatures is not required for the sale of state or municipal property, or in privatisation transactions, where the simple written form is sufficient for a valid title transfer. There are also special rules and procedures governing the acquisition of real estate upon enforcement, insolvency and similar procedures, and for in-kind contributions involving real estate. Regardless of the applicable special rules, these transactions are also subject to registration with real estate register of the relevant registry agency office at the location of the real estate in order to protect the ownership title of the acquired against third parties.

The registry agency office registers the respective transaction in the file of each of the parties to the transaction. All registrations in the real estate register of the registry agency offices are publicly accessible. Such registration gives the potential buyer of real estate the opportunity to check whether:

a the seller is the actual owner of the real estate;

b there are any encumbrances or any third-party rights registered for the respective real estate; and

c whether there are any injunctions prohibiting the sale of the real estate.

As claims related to real estate are also subject to registration with the real estate register of the registry agency offices, the potential buyer could also verify the existence of ownership disputes related to the real estate.

Bulgarian law envisages the creation of a new land registry; however, this is not ready yet. Unlike the current registration at the registry agency offices, which record the transactions in the files of parties to the transaction, the new land registry will record all transactions in the file of the particular real estate, which will make information consistent and more easily accessible.

In general, under the Bulgarian Code on International Private Law, Bulgarian law will govern the ownership rights and other property rights over real estate located in Bulgaria. In particular, Bulgarian law will cover:

a the existence, type and scope of ownership rights and other property rights over real estate located in Bulgaria;

b the holder of the ownership rights and other property rights over real estate located in Bulgaria;
c the transferability of ownership rights and other property rights over real estate located in Bulgaria;
d the means for establishment, change, transfer and discharge of ownership rights and other property rights over real estate located in Bulgaria; and
e the necessity of registration and priority of ownership rights and other property rights over real estate in Bulgaria against third parties.

Further, Bulgarian law will also govern the acquisition and discharge of ownership rights and other property rights over real estate located in Bulgaria. Regulation (EC) No. 593/2008 (Rome I Regulation) could allow choice of law by the parties for contractual issues different from acquisition and discharge of property rights in real estate in Bulgaria (subject to the application of the overriding mandatory provisions of Bulgarian law and Bulgarian public policy), but the scope of such choice of law will be very limited, and will have little practical effect.

II OVERVIEW OF REAL ESTATE ACTIVITY

In 2017, real estate activity in Bulgaria was largely focused on acquisition of operational commercial centres. Based on publicly available information, some of the biggest commercial centres in Bulgaria, such as the Paradise Center, the Serdika Center and the Mall (all three located in Sofia), Galleria Mall Stara Zagora and Galleria Mall Burgas, were sold to new owners. Another commercial centre in Sofia – the Mall of Sofia – is also in the process of being sold.

In 2018, however, it is expected that real estate activity will be focused on residential and office buildings rather than on commercial centres. On the one hand there is currently a boom in the construction of residential buildings, and the market for residential properties seems to be peaking with prices of real estate reaching pre-crisis levels. On the other hand, substantial growth was also recorded in the construction of office buildings in 2017. Even though a number of office buildings have become operational, it seems that strong demand for quality office space still exists, and it can be expected that more office buildings will be completed in 2018, and that there will be further acquisitions of office buildings.

Another surprising trend is the growth of construction of industrial facilities. While construction in previous years was focused more on public projects (e.g., highways and road infrastructure), construction of industrial buildings, including plants, warehouses and logistic facilities, in particular around new industrial centres such as Plovdiv, became significant in 2017 and could be expected to continue to grow in 2018.

III FOREIGN INVESTMENT

Foreign individuals and foreign legal entities can freely acquire ownership over buildings, parts of buildings (e.g., apartments) or limited property rights over land (e.g., a right to construct a building in other person's land plot) but without the land itself.

There are certain legal restrictions on foreign individuals or foreign companies acquiring land in Bulgaria. In particular, under the Act on Ownership, only citizens of Bulgaria or an EU or EEA country, and legal entities from Bulgaria or an EU or EEA country, may acquire ownership over land in Bulgaria. Any foreign company other than an EU or EEA company could acquire land in Bulgaria only if provided under a treaty concluded between the country where company is resident and Bulgaria. However, Bulgaria has not entered any such treaty yet. The same requirements would apply to agricultural land under the Act on Ownership and Use of Agricultural Lands, and to forest land under the Forests Act.

There is one additional requirement for the acquisition of land under the Act on Ownership and Use of Agricultural Lands, which applies if the land is agricultural: only citizens of Bulgaria or an EU or EEA country and legal entities from Bulgaria or an EU or EEA country, that have been residing in Bulgaria for at least five years, may acquire agricultural land in Bulgaria. When a Bulgarian legal entity has foreign shareholders, it may acquire agricultural land only if each of these shareholders has been residing in Bulgaria for at least five years.

Pursuant to the Act on Ownership and Use of Agricultural Lands, the following legal entities may not acquire agricultural land in Bulgaria:

a commercial companies whose shareholders are directly or indirectly registered in offshore jurisdictions;

b commercial companies that have shareholders other than citizens of Bulgaria or an EU or EEA country or legal entities from Bulgaria or an EU or EEA country; and

c joint- stock companies that have issued bearer shares.

There are no incentives for acquisition of real estate by foreign investors.

IV STRUCTURING THE INVESTMENT

An investment in real estate in Bulgaria by a Bulgarian investor is typically carried out through a Bulgarian limited liability company (LLC) or a Bulgarian joint-stock company (JSC). Foreign investors also use Bulgarian LLCs or JSCs for their real estate investments in Bulgaria, although some foreign investors acquire real estate in Bulgaria through branches of foreign companies registered in the Bulgarian commercial register.

An LLC or JSC could be set up and registered in about one month, which includes execution of all incorporation documents, payment of a capital contribution and registration of the company with the Bulgarian Commercial Register. Even though a registration of a branch of a foreign company will be generally faster and less complex then the incorporation of a Bulgarian subsidiary (no capital contribution is required), most foreign investors prefer to acquire real estate through a Bulgarian subsidiary (LLC or JSC) for limitation of liability and tax reasons.

If a Bulgarian subsidiary is used, the liability of its parent company will be limited. The foreign parent company will be liable to make all capital contributions due for the subscription of the shares in the Bulgaria subsidiary, but will not be liable for the obligations of the subsidiary. As a separate legal entity, the Bulgaria subsidiary will be liable for its own obligations with all its own assets.

If the foreign investor acquires the real estate through a branch in Bulgaria, its liability for the obligations of the branch will be unlimited. The branch does not have a separate legal personality, and if it assumes obligations and enters into contracts, this would be binding upon the foreign company.

From a tax perspective, the Bulgarian subsidiary would be more advantageous than the branch owing to complications related to the taxation of the profits of the branch in Bulgaria.

The taxable profits of the subsidiary would be subject to 10 per cent corporate income tax under the Corporate Income Tax Act. This taxable profit is based on profits accounted for by the subsidiary in its books (which are further adjusted for tax purposes by adding back expenses recognised in accounting that are not deductible for corporate income tax purposes). It includes revenues that are not recognised in the accounting, but that are taxable.

The branch will trigger a permanent establishment of the foreign company in Bulgaria, and the taxable profits of the foreign company attributable to such permanent establishment will be subject to 10 per cent corporate income tax in Bulgaria under the Corporate Income Tax Act. As in the case of a subsidiary, the taxable profits of the permanent establishment will be determined based on the accounted profits, which could be subject to additional adjustment for tax purposes.

However, the taxation of the profits of the permanent establishment will be more complicated than the taxation of the subsidiary because there could be difficulties in determining what part of the profits of the foreign company is attributable to its permanent establishment in Bulgaria. Further, the profit or loss reported from internal dealings between the branch and the head office of the foreign company, such as acquisition financing, could be subject to additional adjustment for tax purposes.

The parent company could finance the subsidiary by equity or by means of a shareholder loan with market-based interest. Additionally, if the subsidiary is an LLC it could also be financed through additional cash contributions, which represent be non-interest bearing debt.

The head office could finance its branch though provision of funds, but such provision of funds does not represent a loan because the branch and the head office are part of the same legal entity.

From a tax perspective, the main advantage of the subsidiary over the branch in terms of a shareholder loan is the possibility of interest expense deduction. The subsidiary may deduct interest expenses arising out of the interest-bearing shareholder loans from its taxable profits subject to thin capitalisation restrictions.

Unlike the subsidiary, the branch generally may not deduct interest expense upon provision of funds by the head office. By way of exception, interest expenses incurred on a third-party loan obtained by the head office solely for the activity of the permanent establishment and provided to the permanent establishment could be tax deductible in Bulgaria.

However, in case of a shareholder loan granted to the subsidiary, the subsidiary could have to withhold 10 per cent tax on interest income accrued to the parent company. Such withholding tax will not be due if:

a the parent company qualifies for a tax exemption on interest payments applicable to associated EU companies; or

b the parent company is tax resident in a country that has a double tax treaty with Bulgaria, which exempts the interest income from Bulgarian tax.

A subsidiary can expatriate profit to the parent company through distribution of dividends. A branch can freely remit its profits to the head office as it is not a separate legal entity. From a tax perspective, there is no difference in terms expatriation of profits between a subsidiary and a branch if the parent company is a tax resident in an EU or EEA country because:

a distribution of dividends from the subsidiary to the parent company will be exempt from withholding tax in Bulgaria; and *b* the remittance of profits from the branch to the head office is not subject to Bulgarian withholding tax.

However, if the parent company is not a tax resident in an EU or EEA country, the distribution of dividends could be subject to 5 per cent withholding tax, while there will be no tax upon remittance of profits from the branch. In such a case, the branch will be a more advantageous solution.

If an investor decides to acquire real estate through a Bulgarian subsidiary, an LLC will be more appropriate than a JSC because of its simpler corporate governance and capital requirements.

The corporate governance structure of the LLC includes one or several managing directors who are responsible for the day-to-day operations of the LLC. The JSC has a more complex corporate governance structure, comprising a one or two-tier board system. The existence of a board structure in the JSC may be deemed as more cumbersome compared to the LLC as it requires appointment of more directors and respectively more documentation (board resolutions, notarised declarations and consents by each board member).

The minimum capital required for the establishment of an LLC is 2 Bulgarian lev. If the incorporation capital of the LLC is higher than the minimum required under Bulgarian law, at least 70 per cent of the capital should be paid before the registration of the LLC in the Commercial Register. The minimum capital required for the establishment of a JSC is 50,000 Bulgarian lev, at least 25 per cent of which shall be paid before the registration of the JSC in the Commercial Register, and the remainder paid within two years of incorporation of the JSC.

An investor can also structure its investment in Bulgaria through the local version of a real estate investment trust (REIT) – a licensed special purpose vehicle in the form of a JSC, which can use funds, raised by issuance of securities in real estates or receivables. Investors use this licensed special purpose mainly for tax reasons. Its profits are not subject to corporate income tax, but any dividends distributed by its shareholders are taxable.

V REAL ESTATE OWNERSHIP

i Planning

Under the Territorial Development Act, an owner can only construct on its land based on a detailed development plan that is approved by the competent authorities (usually the mayor or the municipal council of the respective municipality, but in some cases also the regional governor or the minister of regional development). Such detailed development plan will determine the designation of the land plot and the construction parameters for the construction therein, such as type and height of the building or buildings to be constructed, the maximum density and intensity allowed, as well as any minimum green areas.

In order to obtain approval for a detailed development plan (or an amendment of an existing detailed development plan) for its land plot, the investor should apply to the competent authorities for permission to develop such plan. Once permission to develop a detailed development plan is obtained, the investor should complete the following steps:

a organise the preparation of a detailed draft development plan by a licensed designer;

b obtain all necessary environmental authorisations from the environmental authorities (e.g., an ecological assessment of the draft plan or an environmental impact assessment of the project);

c obtain all concurrencies from any relevant special controlling authorities (e.g., fire safety authorities, public health authorities);
d obtain approval for change of designation of agricultural or forest lands from the respective authorities (if applicable);
e organise public consultations regarding the draft plan; and
f apply for approval of the plan before the competent authorities.

Once all these steps are completed, the authorities can approve the detailed development plan. Any interested party can appeal the approval before the courts. If there is no appeal or the courts reject any appeal against the plan, the detailed development plan will enter into force and the investor may proceed with applying for approval of design for the project and issuance of a construction permit.

ii Environment

Under the Act on Protection of the Environment, any legal entity or individual that owns or occupies land shall refrain from actions that may cause adverse changes to the soil in their land, as well as the neighbouring plots of land. This Act further obliges any individual or legal entity that causes adverse changes to the soil to restore the original conditions of the soil at its own cost.

If an owner or a user of a real estate breaches any of these obligations and causes contamination of land, he or she could be subject to three types of environmental liability for contaminated land under Bulgarian law:
a liability to indemnify a third party for damages suffered by the third party;
b liability to prevent or remedy environmental damages if the owner or the user of the land plot is certain type of operator; and
c administrative liability for violations of the legislation for protection of the environment.

The liability to indemnify a third party for environmental damages suffered arises under the Act on Obligations and Contracts, which reads that any person who negligently or intentionally causes damage to other person is obliged to indemnify such damage. Furthermore, any person whose property (including the person who supervises the property) causes damage to other person is obliged to indemnify such damage regardless of fault. Finally, any person who has commissioned work (any type of work, including employment) to an individual and this individual negligently or internationally causes damage to a third party is obliged to indemnify such damage. Depending on the particular circumstances, all three types for liability to indemnify could be applicable to the owner or the user of the land who caused the pollution.

In addition, under the Act on Protection of the Environment, any person who negligently or intentionally causes damage to another person resulting from pollution or impairment of the environment is obliged to indemnify such damage.

Liability to prevent or remedy environmental damages arises under the Act on the Liability for Prevention and Remedying of Environmental Damage, which provides a number of rules for prevention or remedy of environmental damages resulting from certain activities based on the 'polluter pays principle'. The Act on the Liability for Prevention and Remedying of Environmental Damage does not give individuals and legal entities a right of monetary indemnity because of environmental damage, but makes the polluter responsible for the costs of prevention and remedy of the environmental damage.

Finally, if the owner or the user of the real estate has violated environmental legislation he or she may be subject to various administrative sanctions in the form of fines.

iii Tax

Real estate transfer tax is due upon the acquisition of real estate for consideration. The tax rate ranges from 0.1 per cent to 3 per cent on the higher of tax valuation of the real estate and the purchase price, depending the municipality where the real estate is located. The acquirer of the property owes real estate transfer tax unless the parties agree otherwise.

In addition to real estate transfer tax, the acquisition of real estate will trigger notary fees and registration fees.

Notary fees will be owed to the notary for the execution of the notary deed. Notary fees are statutory determined and their amount depend on the purchase price, but may not exceed 6,000 Bulgarian lev, VAT excluded.

Registration fees are owed for the registration of the acquisition of the real estate with the registry agency office. Registration fees are set at 0.1 per cent of either the tax valuation of the real estate or the purchase price – whichever is higher.

Certain real estate transactions are subject to 20 per cent VAT.

iv Finance and security

The most common forms of security granted over real estate under Bulgarian law are mortgage and going concern pledges.

The mortgage is a security for a debt over a particular real estate. A mortgage can be created over:

a a land plot;
b a building or any construction permanently attached to the land; or
c a future building to be constructed in a land plot (provided that the future building is adequately described through reference to a project design approved by the competent authorities).

Under the Act on Obligations and Contracts, the mortgage could be either a contractual mortgage or a statutory mortgage. A contractual mortgage is a mortgage that is created by an agreement between the debtor, the creditor and the mortgagor (if different from the debtor) in the form of notary deed for mortgage. Subsequently, the notary deed for mortgage is registered with the real estate register of the relevant registry agency office to be perfected against third parties.

A statutory mortgage is established by operation of law (no agreement between the parties is necessary) upon request to the real estate register of the relevant registry agency by:

a a seller of real estate to secure payment of the purchase price by the buyer;
b a former co-owner of real estate to secure payment of compensation owed by other former co-owners upon the partition of the real estate; or
c a bank, to secure a loan for the acquisition of the real estate by the buyer.

A going concern pledge is a security for debt over a commercial enterprise (e.g., the totality of rights, obligations and factual relations of a company). As the commercial enterprise of the company includes all rights of the pledgor, including real estate, the going concern pledge will also be a security over the real estate owned by the pledgor. However, a going concern pledge is a floating charge, which changes in quantity and value over time and crystallises upon foreclosure.

Following the creation of a going concern pledge, the pledgor will continue its ordinary business and the going concern pledge will extend over any new assets acquired by the pledgor (including real estate). Further, any assets (including real estate) that the company has sold or otherwise transferred will drop out of the going concern pledge, and will not serve as security of the secured creditor upon foreclosure. By way of exception, if the assets, part of the going concern (including real estate), have been individually described in the pledge agreement, then in the event of their transfer the pledge charge will follow the transferred asset to any new owner of these assets.

The going concern pledge should be registered in the commercial register, in the central register for special pledges and in the real estate register of the relevant registry agency office in order to be perfected against third parties.

VI LEASES OF BUSINESS PREMISES

Under the Act on Obligations and Contracts, a lease agreement will give the lessee the right to use real estate for a certain period against payment of a rent. Under the case law of the Bulgarian courts, the lease agreement will be valid only if the amount of the rent is determined, or is at least determinable. The parties are free to agree the mechanism for calculation of the rent. The rent could be determined as a fixed amount or could be based on a formula (e.g., turnover rent determined as a percentage of the turnover in the leased premises). Typically, leases of residential or administrative premises have a fixed rent (usually paid monthly), while leases of retail premises have a turnover rent (in such cases there are usually fixed monthly advance payments of the rent and annual reconciliation based on the actual turnover). Fixed rent is usually subject to annual indexation.

The lessee will pay all utility costs for water and electricity consumed in the leased premises based on utility meters installed by the lessor in the premises. When the leased premises are part of a building, the lessee could also pay part of the heating, ventilation, and air conditioning costs for the entire building.

In addition to the rent and the utility costs, the lessee typically pays a refundable deposit to the lessor as a security for the fulfilment of the lessee's obligations under the lease agreement. The amount of the deposit is determined on a case-by-case basis, but it is typically in the amount of the rent and the service charge for two or three months, plus VAT. The lessor should refund the deposit to the lessee upon expiry of the lease term or the termination of the lease agreement, unless there are outstanding obligations of the lessee, which are set-off against the amount of the deposit. The lessor frequently requests that, instead of transferring the deposit, the lessee provide an unconditional first-demand bank guarantee issued from a reputable bank, covering the amount of the deposit. As with the deposit, the lessor should return the bank guarantee to the lessee upon the expiry of the lease term or the termination of the lease agreement, unless there are outstanding obligations of the lessee, for which the lessor draws from the bank guarantee.

Most of the provisions of a lease agreement are subject to negotiations between the parties. However, in the absence of a specific agreement to the contrary, certain statutory provisions of the Act on Obligations and Contracts that regulate the specific matter will apply:

a at the end of the lease term, the lessee will return the leased premises in the same condition in which it was given; otherwise, the lessee will compensate the lessor for the damages;
b structural repairs (unless caused by the negligence of the lessee) are performed by and on behalf of the lessor;
c unless otherwise agreed, the lessor is able to sublease the leased premises (within to the scope and the terms of the initial lease agreement);
d if it is not terminated at the end of the lease term, a lease agreement continues to be valid as a lease agreement for an undefined term; and
e the lessor will be entitled to receive compensation if the lessee does not return the leased premises to the lessor at the end of the leased term.

Generally, the maximum lease term is 10 years. However, if the lease agreement is a commercial transaction (e.g., if the lessee and the lessor are merchant companies), which is the typical situation for leases of business premises, there are no limitations to the length of the lease term or its extensions, so the lease term could be longer than 10 years. If the lease agreement does not have a specified lease term, it will be a lease agreement for an undefined term and each of the parties can terminate it with one-month's notice unless agreed otherwise.

Under Bulgarian law, if the lessor transfers the leased property to a new owner during the lease term, the lease agreement will be binding for the new owner as follows:
a if the lease agreement is registered with the respective registry agency office, it will be binding for the entire agreed lease term;
b if the lease agreement is not registered with the respective registry agency office, but has a reliable date (e.g., it is notary certified), it will be binding for the agreed lease term, but for not more than one year; and
c if the lease agreement is not registered with the respective registry agency office and does not have a reliable date, but the lessee is in physical possession of the leased premises, it will be binding as an agreement with indefinite lease term, which means that the new owner can terminate the lease agreement with one month's prior notice.

There is no required form of validity of the lease agreement; however, typically, lease agreements for business premises are in writing for evidentiary purposes. Frequently, the parties will obtain notary certification of their signatures under the lease agreement in order to register the lease agreement with the respective registry agency office so that the lease agreement could be binding to any new owner of the leased premises.

VII DEVELOPMENTS IN PRACTICE

There are a number of recent developments in real estate law and practice, detailed below.

i Case law on mortgage extending to future buildings on mortgaged land

In several recent decisions, the Bulgarian Supreme Court of Cassations has accepted that a mortgage over land plot could extend over a building that will be built in the future on the mortgaged land plot, if the building is properly described in the notary deed for mortgage by reference to construction documents approved by the authorities. Full identification of all premises in the building is not necessary. Upon completion of the construction of the building, the owner of land plot will become owner of the entire building owing to the principle of accretion, and the mortgage over the land plot will also extend to the newly constructed building. This case law is very important for real estate financing as it would allow the security to extend over any future improvements in the land plot, thus enhancing the value of the security.

ii Lack of resolution of the shareholders for acquisition or disposal of real estate

Under the Commercial Act, the general meeting of the shareholders in a limited liability company should take a corporate resolution for the acquisition or transfer of real estate by the company. Until recently, the case law of Bulgarian courts was inconsistent regarding whether a transaction for acquisition or transfer of real estate is valid if there is no corporate resolution. Such inconsistency has recently been overcome by an interpretive decision of the Supreme Court of Cassations, which held that the transaction for acquisition or transfer of real estate will be valid even if there is no corporate resolution of the general meeting of the shareholders for the transaction. In the view of the court, the lack of such resolution could have legal consequences for the company and the managing director who authorised the transaction, but not for the other party of the transaction. This decision is important, particularly in terms of preliminary agreements for sale of real estate, as the other party to the transaction does not have effective means to ensure that all necessary corporate authorisations are obtained.

iii Form of corporate resolution for acquisition or transfer of real estate

Pursuant to amendments to the Commercial Act, effective as of January 2017, the corporate resolution of the shareholders in a limited liability company for acquisition or transfer of real estate by the company should follow a protocol where both the signatures and content of the document should be notary certified. This practically eliminates the possibility for such certification to be executed by a non-Bulgarian notary, as only in very few jurisdictions will the notary public certify the content of a document. This makes execution of resolutions for acquisition or transfer of real estate in a limited liability company with a foreign shareholder difficult. To avoid such complications, the foreign shareholder should authorise a local proxy to execute all protocols on its behalf.

iv Content of powers of attorney for real estate transactions

Until recently, there was inconsistent case law regarding the content a power of attorney for transactions involving disposal of real estate. Different courts accepted that in order to be valid, the power of attorney should explicitly state the transaction for which the proxy is authorised, as well as the main conditions of the transaction. With a recent interpretive decision of the Supreme Court of Cassations, this case law has been overruled. Under this decision, it is sufficient that the power of attorney states that the proxy is authorised to dispose of the real estate without the need to specify any particular details of the transaction. This new development eases the preparation of the documentary package necessary for sale of real estate, as often some main terms of the transaction, including the price, are being negotiated until the last possible moment.

v Priority of public sale buyer versus lessee under registered lease

As noted above, if a lease agreement is registered with the real estate register and leased property is sold to a new owner, the lease agreement will be binding to the new owner for its entire lease term. Bulgarian case law accepts that this would also apply if the real estate is sold through a public sale. However, recent amendments to the Civil Procedural Code limit the rights of the lessee under registered lease if the lease agreement has been registered in the real estate registry after the first mortgage. In such case, the buyer under the public sale can take out the lessee from the lease property, despite the lease agreement being registered.

VIII OUTLOOK AND CONCLUSIONS

There are no major anticipated developments in terms of Bulgarian law. As noted above, it is expected that a new land register will be introduced where all transactions will be recorded under the file of the property. This land register will be integrated with the cadastral register (where each property is recorded by a unique cadastral number), so it will be possible for an investor to obtain easily comprehensive information regarding the legal status of any property.

There are few pending cases before the Supreme Court of Cassations that refer to transfer of real estate in public sales, but these decisions are unlikely to have a major impact on real estate transactions in Bulgaria.

Chapter 8

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) (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 (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;

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 that, 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 a person and the rights are not disclosed; and

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1 George Loutas is an associate at Maples and Calder.

2 Originally conceived by Sir Robert Torrens in South Australia.

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, below).[5]

II OVERVIEW OF REAL ESTATE ACTIVITY

The year 2017 was strong in terms of real estate activity in the Cayman Islands and 2018 appears like it is going to be strong too.

There was an abundance of activity in the hotel tourism sector, including:

a the sale of the Ritz Carlton Grand Cayman Resort to the Dart Group;

b the renovation of the Westin Grand Cayman Seven Mile Beach Resort & Spa and the Sunshine Suites;

c the ongoing renovation of the former Treasure Island Resort and its rebranding as a Margaritaville Resort by a Canadian-based consortium;

d the finalisation of the Kimpton Hotel on Seven Mile Beach; and

e discussions regarding a proposed Four Seasons Hotel.

Additionally, the Dart Group has been busy progressing with its realignment of parts of West Bay Road (on the Seven Mile Beach seafront), the construction of a tunnel and overpass as well as the widening and extension of the Esterly Tibbetts Highway, all part of a strategic plan to maximise the position of its significant land holdings in Grand Cayman.

3 Sections III and IV of the RLL.

4 Ibid.

5 Section III of the RLL.

On the infrastructure front, the Owen Roberts International Airport is in the process of being expanded dramatically and the government is in the process of the tender of a cruise port in George Town to accommodate the Genesis class of cruise ships.

III FOREIGN INVESTMENT

As mentioned in Section I, above, 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 (2014 Revision) (TBL Law) and the Local Companies Control Law (2015 Revision) (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 a 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 (2015 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 (2015 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.

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 a 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, above).

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

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

(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 (2016 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, above). 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 (2017 Revision) (DPL), the Development and Planning Regulations (2017 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 (the 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 5 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 an 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. 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 2014 and 2015, 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, because of 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 because of the increased sophistication and volume of strata titled developments in the Cayman Islands.

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

VIII OUTLOOK AND CONCLUSIONS

The year 2017 was strong in terms of investment in real estate in the Cayman Islands, and all indications point to 2018 being very promising in terms of real estate development in the jurisdiction, especially in the areas of infrastructure, tourism and hospitality projects. On the infrastructure front, the Owen Roberts International Airport is in the process of being expanded dramatically and the government is in the process of discussing the development of a cruise port in George Town to accommodate the Genesis class of cruise ships.

Chapter 9

CHINA

William Mo and Eric Liu[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. The two basic types of land use rights in China are granted land use rights and allocated land use rights.[2]

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.[3] Upon the expiration of the granted term, the usage right and the title to the structures thereon revert 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.[4]

In contrast to granted land use rights, 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 generally grants allocated land use rights for no fee, but the state also retains the right to retake the land at any time without compensation (however, the structures and other attachments on the land shall still be compensated in light of the actual circumstances).[5] Allocated land use rights generally cannot be transferred, leased or mortgaged, although it is not uncommon to do so as a matter of practice.[6] The risk, albeit increasingly remote, of forfeiture without compensation makes allocated land use rights unfavourable for commercial investment.

1 William Mo is a senior partner and Eric Liu is a partner at Dentons.
2 China also recognises 'collective' or 'cooperative' land use rights.
3 In 2014, a number of cities, including Shanghai, Shenzhen and Foshan, as well as a number of industrial zones, adopted local regulations that shorten the maximum term for new grants of land use rights for certain industrial uses from 50 years to 20 or 30 years.
4 Articles 12, 40 and 41 of the Tentative Regulations on Land Use Right Grant and Assignment for Land in Urban Areas. Note, however, that Article 149 of the Property Law does not expressly provide that an extension of the granted term for residential property requires the holder of such rights to pay an extension fee.
5 Article 23 of the Law on Administration of Urban Real Properties and Article 47 of the Tentative Regulations on Land Use Right Grant and Assignment for Land in Urban Areas.
6 Article 5 of the Tentative Measures for Administration of Allocated Land Use Rights.

ii Property registration

China has a well-established system of land registration. When transferring land use rights or the title to building structures thereon, or both, the transacting parties must register the change with the local real estate authority in the jurisdiction where the land is located. In some cities, there are separate governmental authorities that register land use rights and the title to buildings upon the land. In other cities, like Shanghai, the real estate authority in the relevant city district registers the transfer of title to both land use rights and buildings. The government has been working to establish a unified national real estate registration system that consolidates all registries for land, building and other forms of property rights (including usage rights to forests, mountains and maritime space). Legislation for the national registry[7] was passed by the State Council (the Chinese central government) on 24 November 2014. Since the legislation came into effect, there has been an increasing number of local governments (including Beijing, Guangzhou and Shenzhen) that have established a unified real estate registration system. The unified real estate registration system is expected to be implemented nationwide in 2016.

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.[8]

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

II OVERVIEW OF REAL ESTATE ACTIVITY

i Residential property

In 2017, Chinese policy adhered to the principle that 'the house is for living in not for speculation', and purchase and loans for real estate are limited. Since March 2016, Shanghai and Shenzhen have set limits on the purchase of real estate. For instance, the proportion of down payment has increased (in Shanghai, down payments on the first property, the second property and non-ordinary house purchased by the individual shall be respectively

7 The Interim Regulations on Real Estate Registration, issued by the State Council on 24 November 2014 and taking effect on 1 March 2015.

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

no less than 35 per cent, 50 per cent and 70 per cent of the total value of the property),[9] the bank lending rate has increased since 2015 and down payment loans and bridge loans are prohibited in property purchase.[10]

ii Retail and office property

Because of the limitations in residential property transactions, investors have turned to office property (especially for the first three quarters of 2017). According to data from the National Bureau of Statistics, the total amount of investment in office buildings reached 497.8 billion yuan, an increase of 5.4 per cent compared to the previous year; and that of commercial buildings was 1.171 trillion yuan, which has increased 1.4 per cent compared to the previous year. Although it was oversupplied, the vacancy rate did not decline. The problem of idle commercial housing still exists.

iii Foreign investment

On 6 November 2015, the Ministry of Commerce and State Administration of Foreign Exchange (SAFE) issued legal documents that further simplify the administration on foreign-invested real estate enterprises. On 11 January 2017, the PBOC specified that during the one-year transition period, it is optional for foreign-invested enterprises to apply the existing foreign debt management system, which makes it possible for them to borrow foreign debts. Therefore, according to the latest data from the Ministry of Commerce, foreign investment in the Chinese real estate sector reached 11.174 billion yuan from January to August in 2017, a 15.4 per cent increase from the previous year.

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 SAFE all foreign loans or debt in either foreign currency or yuan borrowed from non-PRC residents or entities. Failure to register will result in the unenforceability of the loan agreement and an inability to subsequently convert or remit the principal and interest to the offshore lender.[11]

Following the release of Circular 130 in July 2007,[12] SAFE will not process any foreign loan, register debt or settle foreign exchange loans for foreign-invested real estate enterprises (FIREEs) that were approved by and filed with the Ministry of Commerce (MOFCOM)

9 Notice of Shanghai Municipality on Promoting a Steady and Healthy and Orderly Development of Real Estate Market and Further Perfecting Differentiated Housing Credit Policy.

10 Opinions on Further Perfecting the Urban Housing Market System and Security System and Promoting the Steady and Healthy Development of the Real Estate Market.

11 Articles 38 and 40 of the Tentative Measures for Administration of Foreign Debts and Article 4 of the Notice on Regulating Cross-border RMB Capital Account Operations issued by the General Affairs Department of SAFE on 7 April 2011.

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

on or after 1 June 2007. As such, offshore parent companies and investors are no longer permitted to extend shareholder loans or inter-company loans to FIREEs except for those completed MOFCOM approval and filing before 1 June 2007. Circular 130 was repealed on 13 May 2013; however, the same restriction was restated in the Guidance on the Administration of Foreign Debt Registration (Circular 19) issued by SAFE on the same date, and Appendix II of Circular 19 was revised on 4 May 2015. Circular 19 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.

Domestic debt

Historically, onshore borrowings by FIREEs were generally not considered debt in determining compliance with the debt-to-equity ratio limitations mentioned above. This is because onshore financings by domestic banks were not required to be registered with the government. Consequently, domestic banks were relatively more flexible than their foreign counterparts in extending credit to FIREEs. However, because of regulatory tightening of liquidity, there appears to be an increasing trend among local banks to include yuan 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 yuan-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;[13] and

b domestic banks may not lend to an FIREE unless the bank has determined that the FIREE has 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.[14]

Repatriation

Because of regulatory restrictions and the limited convertibility of the yuan, 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,[15] and may be reduced up to 5 per cent under certain tax treaties. The effectiveness of dividend distributions as a method

13 Article 29 of the Tentative Measures for Administration of Fixed Asset Loans.

14 See the 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, as amended by the Circular on Adjusting Policies on the Market Access and Administration of Foreign Investment in the Real Estate Market, issued by Ministry of Housing and Urban-Rural Development and other authorities on 19 August 2015.

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

of repatriation is limited for several reasons: dividends may usually only be declared once per year, real estate projects typically do not have strong dividend paying capacity (i.e., insufficient after-tax accounting retained earnings) and there may be certain cash reserve amounts that are required to be funded from otherwise distributable earnings.

Repayment of shareholder loans

Following Circular 130 and Circular 19,[16] SAFE will not register any foreign loans extended to FIREEs that were approved by or filed with MOFCOM on or after 1 June 2007. This rule, however, has not been retroactively applied to third-party loans or shareholder loans that were made to FIREEs that were approved by and filed with MOFCOM before 1 June 2007. Payment 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

Onshore cash may also be repatriated through a services agreement (e.g., consulting services or IP licence agreement) whereby the onshore project company pays an offshore affiliate for services rendered. Although the fee would be subject to SAFE approval, SAFE authorises local banks to review the 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.

16 See footnote 12.

WFOE

A WFOE is an entity that is owned entirely by one or more foreign investors.[17] Its owners have full control of the entity and any real estate it owns.

EJV

An EJV is a limited liability 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,[18] 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 (ROFR) by all of the other investors in the EJV.[19]

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 or its local counterpart (SAIC)

The first step in forming an FIREE is for the foreign investor to register the proposed name of the FIREE with SAIC.[20] 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.[21]

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17 See the Law on Foreign Invested Enterprises.

18 Under the Notice on the Implementation of the Provisional Regulations on the Duration of Sino-foreign Equity Joint Venture Enterprises, the duration for EJVs is generally limited to 30 years. The permitted duration for certain investment EVJs can be extended to 50 years. EJVs may apply for an extension of the duration six months prior to the original expiration date.

19 See the Law on Sino-foreign Equity Joint Ventures.

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

21 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.

The filing was originally required to be publicised on the website of the highest MOFCOM authority, the national MOFCOM. However, according to a circular[22] jointly issued by MOFCOM and SAFE on 6 November 2015, this public disclosure requirement has been repealed; however, MOFCOM will continue to conduct spot checks on the work performed by the provincial MOFCOM on a quarterly basis.

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:[23]

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$30 million	The greater of 40 per cent of the total investment or US$5 million
Over US$30 million	The greater of one-third of the total investment or US$12 million

The difference between the total investment amount and the registered capital may, subject to certain restrictions (such as those under Circular 19), 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.

22 The Circular of the Ministry of Commerce and the State Administration of Foreign Exchange on Further Improving the Filing Process of Foreign-Invested Real Estate Enterprises.

23 Article 3 of the Tentative Regulations on the Ratio between Total Investment and Registered Capital for Equity Joint Ventures issued by the SAIC on 17 February 1987 and Article 1 of the Circular on Adjusting Policies on the Market Access and Administration of Foreign Investment in the Real Estate Market, issued by Ministry of Housing and Urban-Rural Development and other authorities on 19 August 2015.

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 land and planning authority.[24] Subject to the urban or city overall development plan, the local land and planning authority has discretion to approve the change of usage after internal discussions with 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.[25]

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.[26]

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.[27]

Value added tax (VAT)

Following the VAT reform in 2016, the seller must pay VAT, which is effectively assessed on a net basis (outputs less inputs) for the sale of the real estate and land use rights at the rate

24 Article 6 of the Implementing Regulations for the Law on Administration of Land.

25 Article 82 of the Law on Prevention of Solid Waste Environmental Pollution.

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

27 Article 4 of the Enterprise Income Tax Law.

of 11 per cent.[28] General VAT taxpayers may opt for the general taxation method (11 per cent VAT rate) or simplified taxation method (5 per cent VAT rate) when selling Old Real Property Project or Old Real Property.[29]

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 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 the land premium paid, the cost of the improvements and other taxes on the transfer of the real property.[30]

Deed tax

Purchasers of real property must pay a deed tax of 3 to 5 per cent (depending on jurisdiction) on the total transfer value.[31]

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.[32]

To attract investment, some local governments might agree to return a portion of these taxes 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 the heavy tax burden of an asset sale, the sale of equity is currently subject to stamp duty and a 10 per cent withholding tax for enterprise income tax (i.e., capital gains)[33] or, in some cases, even lower, if the relevant bilateral tax treaty applies. 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 to evade Chinese tax liability.

Announcement 7 and Anti-Avoidance Rules

Under Announcement 7,[34] tax authorities may in certain circumstances disregard the existence of an offshore intermediate holding company (an indirect equity transfer) and tax

28 Articles 2 of the Tentative Regulations on Value-added Tax.

29 The Old Real Estate Project or Old Real Estate is where property developers sell self-developed real estate. The Old Real Estate Project refers to projects with a commencement date that is stipulated on the Construction Permit as being no later than 30 April 2016; for other situations, Old Real Estate refers to real estate that is obtained or self-built by taxpayers no later than 30 April 2016.

30 See the Tentative Regulations on Land Appreciation Tax.

31 Article 3 of the Tentative Regulations on Deed Tax.

32 Article 3 of the Tentative Regulations on Stamp Duty.

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

34 Announcement Concerning Several Matters Relating to Corporate Income Tax on Indirect Transfer of Properties by Non-Tax Resident Enterprises issued by the State Administration of Taxation on 3 February 2015.

the sale of shares in such a company as if it were a direct transfer of shares in the underlying Chinese company if, among other things, the indirect equity transfer lacks a 'reasonable commercial purpose'.

According to Announcement 7, the reporting of an indirect equity transfer to the Chinese tax authority is voluntary (rather than mandatory) and such a report may be submitted by the buyer, the seller, or the underlying Chinese subsidiary. Given the uncertainty as to the potential tax liabilities under Announcement 7, parties to an indirect equity transfer (particularly, the buyer) may have strong motivations to proceed with the voluntary reporting.

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.[35] 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 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.

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

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 ROFR

PRC law provides tenants with a statutory ROFR with respect to the sale of leased premises. 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

In 2015, the authorities introduced measures to encourage transactions in the residential property market. They relaxed minimum down payment requirements on home purchases and loosened qualification requirements for reduction of business tax on second-hand house sellers in March. From March to October 2015, the PBOC lowered the benchmark loan rates five times to encourage borrowing for home purchases, and increased the rates in 2017. While Beijing, Shanghai, Guangzhou, Shenzhen and Sanya remain the only places in China that continue to maintain restrictions on home purchases, the local governments in other cities and municipalities have either formally or informally eased prior restrictions aimed at curbing property price appreciation and speculation.

Another key development is the establishment of three new free trade zones (in additional to the one in Shanghai, which was established in September 2013), in Fujian, Guangdong and Tianjin respectively. Following the establishment of these free trade zones, a number of regulations were released to liberalise inbound investments by foreign investors in several industry sectors, including finance, shipping, commercial and professional services. In addition, inbound investments in these free trade zones are generally permitted unless the investment is in a sector that is prohibited or restricted by the government.

VIII OUTLOOK AND CONCLUSIONS

Since a transition in national leadership in 2013 and the strengthening of such in October 2017, China's new leadership has focused on a nationwide anti-corruption campaign and wide-ranging economic reforms, both of which contributed to the slowing of China's property markets. The priorities of China's leadership shifted in 2014, with authorities more concerned with increasing economic growth. This shift has carried over to the real estate market, where the authorities have undertaken measures to bring back growth. While authorities still express concern at preventing asset bubbles within the real estate market, measures to ease restrictions on home ownership and to increase mortgage lending are intended to breathe new life into this sector. In light of these measures, and continued demand for housing in many Chinese cities, the residential property market is expected to grow in 2016. Retail, office and industrial property sectors are expected to experience modest growth overall. The 2016 real estate market's focus will be on finding a better balance of supply and demand for regulators, developers and investors.

Chapter 10

CROATIA

Ana-Marija Skoko and Tamara Jelić Kazić[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

In Croatia, ownership is the most comprehensive right a person or legal entity can hold in relation to real estate. The right of ownership is defined as a property right (right *in rem*) on a particular object, authorising the holder to use the object and any benefits arising therefrom as he or she sees fit, and to exclude any other person from it, unless that is contrary to the other person's rights or limitations imposed by the law. The owner's rights include possession, use, utilisation and free and unlimited disposal of any kind.

Where more than one person or legal entity has ownership over a single piece of real estate, they will hold their interest as follows:

a co-ownership – each owner has a defined share over the real estate. Each co-owner is entitled to dispose freely of his or her co-ownership share.

b joint ownership – the shares of the joint owners are not fixed. All owners can only dispose of the real estate (being jointly owned) together.

c condominium – this is a specific type of ownership, predominantly used for apartments. Co-owners of real estate may agree to limit their co-owner's rights by connecting the ownership of a particular part of the real estate (an apartment) to their co-ownership share of the co-owned real estate.

In Croatia there is no leasehold ownership. A lease does not create a property interest but merely a contractual right to use the property.

ii System of registration

The Croatian system of registration is still divided into two public registries: the land registry, and the cadastre registry. The plan is for the two registries to be merged into a single real estate database – the joint land registry and cadastre information system; while the process is still ongoing, significant milestones were achieved in 2016 and 2017.

The land registry includes information about the real estate and persons having property rights (and certain other rights) over the real estate. Despite its name, it is not a single registry but a common reference to land registry departments of municipal courts around Croatia.

Ownership, as well as other property rights (easements: personal and property; pledges or mortgages; property encumbrances; construction rights), have to be registered with the

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land registry to come into existence, except when acquisition of such rights occurs by virtue of the law or by virtue of a court decision or decision of another state authority. In the latter case, although registration is not material, it should nevertheless be done to protect the acquirer against third persons acquiring rights over the same real estate through acting with trust in the land registry.

On the other hand, the cadastre registry provides detailed descriptions of land plots together with maps showing the shape and position of subject plots as well as buildings situated on them.

iii Choice of law

Croatian law mandatorily applies to transactions regarding transfer of ownership, or any other property rights, over real estate in Croatia. Additionally, Croatian courts have exclusive jurisdiction over disputes regarding ownership, other property rights, possession or lease, of real estate located in Croatia.

II OVERVIEW OF REAL ESTATE ACTIVITY

The global financial crisis has without doubt had a very material effect on the real estate market in Croatia. Especially in 2016 and 2017, the market has started to show promising signs of recovery – to varying degrees depending on the type of real estate (residential, office, retail, commercial, etc.) and its location (Zagreb versus the coast). The recovery is, however, very slow. Croatia is still faced – as other European countries are – with a struggling economy, insufficient economic growth, high unemployment and a high tax burden (though this was lowered slightly, based on the tax reform introduced in January 2017). Mortgages are also a problem locally (in the housing market), as they are tied to the exchange rate of the Swiss franc.

Transactions over the past couple of years have been very limited; notably, a significant increase is to be found in the hotel and hospitality industry, a trend that has continued in 2017. Croatia's ranking as one of the premier tourist spots has made this sector very attractive to investors. A significant number of coastal properties are still state owned, which accounts for public tenders for transactions aimed at the acquisition of such properties. In the past, such transactions were often difficult because of the governments' inflexibility to commercial negotiations – an issue being actively tackled by the new government.

Additionally, a number of international retailers have established a presence on the Croatian market and are likely to continue to do so in the next year, as the government is enacting various tax measures aimed at increasing private spending.

Bank financing opportunities were also affected by the crisis. There have, however, been improvements in financing conditions, especially as regards corporate and retail real estate projects. The status quo is expected to remain unchanged materially over the next year. The overall position is that although financing is available, good projects are difficult to find. As regards the public sector, an investment increase is expected on the basis of access to EU funds; the European Investment Bank is playing a very important role in providing a loan that will cover national co-financing contributions in line with the Partnership Agreement and the 'Competitiveness and Cohesion' Operational Programme in the areas of transport, energy, the environment, health, nature protection, water and waste management.

III FOREIGN INVESTMENT

Any natural person or legal entity may own real estate. In relation to foreign natural persons and legal entities there are, however, certain restrictions, namely such persons may acquire ownership of real estate by inheritance, or with special consent from the Ministry of Justice, in both cases under condition of reciprocity. These rules do not apply to natural persons or legal entities from EU Member States, except in the case of agricultural land and protected natural areas.

Reciprocity is determined on a factual basis – meaning that a foreigner may acquire ownership over real estate in Croatia solely if Croatian citizens can do so in the country of the foreigner's citizenship, and under the same conditions. The existence of reciprocity and conditions for acquisition of ownership over real estate are determined by the formal exchange of letters between the Croatian Ministry of Justice and the competent authority for such matters in the country in which the foreigner is a citizen. Such formal letters have not yet been exchanged for some countries and, therefore, reciprocity with these countries, for practical purposes, is deemed not to exist. The process for obtaining the necessary consent from the Ministry of Justice is somewhat lengthy (three to six months), although not too difficult. It is also worth mentioning that – provided that real estate is being bought from or by a Croatian natural person or legal entity – payment needs to be performed in kuna, due to the fact that purchase of real estate is considered to be a capital legal transaction.

Certain investment incentives are available in line with the Investment Promotion Act. Although no specific real estate investments are mentioned therein, it should be noted that initial investments for entities in tangible or intangible assets of a value that meets certain legally prescribed thresholds, and providing that at least 10 new university degree job positions are opened, can be awarded one or more incentives. Projects should, however, be examined on a case-by-case basis to see if they are eligible for the available incentives.

IV STRUCTURING THE INVESTMENT

Croatian real estate market recognises the standard real estate structures and investment vehicles, such as companies and real estate investment funds.

Companies are the most common and the most preferred investment structures. In practice, companies such as joint stock companies and especially limited liability companies are considered to be the most favourable legal forms. Both forms are considered to be capital companies, in which the shareholders pay into the share capital at the incorporation of the subject company. The limited partnership is a less popular legal form – although still present, and especially so in the case of investors coming from the German or Austrian markets.

Below is an overview of the main features of the above-stated company structures:

	Joint stock company (d.d.)	**Limited liability company (d.o.o.)**	**Limited partnership (k.d.)**
Incorporation	The statement on adoption of the articles of association is to be given as a notarial deed	The articles of association are to be executed as a notarial deed or a private solemnised deed	Partnership agreement (articles of association), does not need to be executed as a notarial deed
Minimum capital at incorporation	200,000 kuna/€26,500	20,000 kuna/€2,650	No requirement
Shareholders	Minimum of one	Minimum of one	Minimum of one limited partner and one unlimited partner

	Joint stock company (d.d.)	Limited liability company (d.o.o.)	Limited partnership (k.d.)
Transfer of shares	Generally free, may be subject to certain conditions and restrictions (minority buyout)	Generally free, may be subject to certain conditions and restrictions as set out by the articles of association or shareholders' agreement	Solely possible with consent of other partners in the company
Liabilities	Limited to the shareholders' participation in the company, unless there is a breach of the corporate veil rules	Limited to the shareholders' participation in the company, unless there is a breach of the corporate veil rules	Unlimited partners' liabilities are unlimited (i.e., an unlimited partner is fully liable for the companies' obligations; in the case of unlimited partners, liability is joint and several). The limited partner's liability is limited to the amount of the limited partner's participation, on the condition that the agreed upon participation has been paid in full
Management	Minimum of one; exact number determined by articles of association	Minimum of one; exact number determined by articles of association	Unlimited partner, special powers of attorney can be given to the limited partner
Supervisory board	Yes; whereas articles of association can determine that company has a single body – management board – instead of separate management and supervisory boards	Mandatory under certain conditions, otherwise may be decided on by shareholders and envisaged by articles of association	No
General assembly	To be held within the first eight months of business year, as determined by law, company articles of association and when so required by the company's interests	Minimum of one annual general assembly per year, as determined by law, company articles of association and when so required by the company's interests	Not required by law; possible if so agreed by partnership agreement (articles of association)

In 2013, Croatia adopted the new Act on Open-Ended Investment Funds with Public Offering and the new Act on Alternative Investment Funds. These were further amended in late 2014 and mid-2016, primarily to ensure implementation of the UCITS IV and the AIFMD in the respective acts. The main idea behind the EU alignment was to decrease dependency on credit ratings determined by credit agencies, and to ensure that independent measures are undertaken to identify, measure and control the risk to which the fund may be exposed, and to strengthen instruments for investor protection. In Croatia, alternative investment funds (AIFs) can be established through public and private offerings, and as open or closed-ended. Open-ended AIFs do not have legal standing, whereas closed-ended AIFs are incorporated either as joint stock companies or limited liability companies. Stakes or shares in an open-ended AIF, and a closed-ended AIF that has been established as a joint stock company, may be the subject of both public and private offerings. On the other hand, stakes or shares in a closed-ended AIF that has been established as a limited liability company may only be the subject of a private offering. In Croatia AIFMs are also established as joint stock companies or limited liability companies, with an additional possibility of incorporation as a societas Europaea (EA) with registered seat in Croatia. The supervision of AIFMs credit assessment process in Croatia falls under the jurisdiction of the Croatian Financial Services Supervisory Agency, HANFA.

As regards taxation of investment, Croatia follows generally accepted corporate profit taxation (CPT) principle: the corporate profit tax base is the difference between revenues and expenditures assessed in the profit and loss statement under the accounting rules and adjusted for tax-specific items under the corporate profit tax regulations. Small enterprises with annual revenue of up to 3 million kuna are taxed at 12 per cent CPT and all other CPT payers at 18 per cent.

Certain payments (such as interest, royalties, dividends) from Croatian companies to non-resident legal persons are subject to withholding tax (WHT) in Croatia. Dividends are taxed at 12 per cent, while interest and royalties at 15 per cent WHT, unless the tax is reduced or eliminated under a tax treaty or payments qualify for an exemption under the relevant EU Directives.

Capital gains are included in CPT base and taxed at the above general rates of 12 or 18 per cent. Certain types of assets are subject to special rules limiting deductibility of depreciation cost.

Sale of shares in a Croatian company by a non-resident company is not taxable in Croatia.

Capital gains realised by private individuals from disposal of financial assets, acquired after 1 January 2016 and disposed of within two years of the date of the acquisition, are subject to 12 per cent personal income tax (plus city surtax).

V REAL ESTATE OWNERSHIP

i Planning

Use of real estate in Croatia is determined by spatial planning programmes and plans that are adopted on the state, regional and local level (city, municipality or specific area). Such plans determine if real estate may be used or developed as, for example, residential, commercial, mixed-use or industrial property.

The general rule is that the higher-level programmes and plans determine the general principles and guidelines, while the lower-level plans work out the general principles and guidelines in more detail. The lower-level plans must always be in line with the higher-level plans.

Change of use (from one category to another, such as residential to commercial property) is possible only if allowed by the applicable spatial planning programmes and plans.

ii Environment

Traditionally, the primary environmental consideration has been potential soil and groundwater contamination as a result of current and former uses. In recent years, this has been broadened to include air, nature and plant life and mineral resources research.

There is a statutory obligation to remedy contamination and to undertake measures to prevent harm from occurring to people and nature. In principle, legal responsibility follows the 'polluter pays' principle (i.e., the person who spilled, released or discharged the offending or hazardous substance will normally be liable). If the polluter is not known, the contamination may be remedied by using funds from the local, regional or state budget. Additionally, under certain conditions, the contamination remedy obligation may pass to the owners and occupiers of the affected property. If the owner of real estate fails to comply with this statutory obligation, the local or regional authorities may sequestrate the real estate to comply with the respective obligations.

iii Tax

Sale and purchase of real estate is, depending on its type and nature, subject to either real estate transfer tax (RETT) at the rate of 4 per cent (reduced from 5 per cent as of 1 January 2017) or value added tax (VAT) at the rate of 25 per cent. Transfer of construction land and transfer of buildings or their parts before the first occupation or use, or within two years of the first occupation or use to the next supply (including reconstructed buildings) are subject to VAT. Transfer of other buildings and agricultural land are VAT exempt and fall under the RETT regime, whereas any input VAT previously deducted needs to be corrected. For VAT exempt supplies, the VAT Act, however, allows an option to apply VAT, but only under the condition that the buyer is a VAT payer with the full right to input VAT deduction relating to that particular supply. The VAT option must be applied at the time of supply.

RETT will apply when the seller is not a VAT payer, irrespective of the type of real estate.

Stamp duty is not due on acquisition of real estate in Croatia.

iv Finance and security

The most common form of security over real estate is a mortgage. The underlying mortgage agreement is usually executed as a notarial enforceable deed, allowing for immediate enforcement over the real estate in the event of default under the underlying financing agreement. Direct enforcement means that in the case of default, the creditor does not have to initiate separate proceedings to ascertain the existence of the claim or default, but may immediately commence proceedings to enforce the mortgage over the real estate. Nonetheless, the debtor is not precluded from raising an objection as regards the claim or default, but can only raise such objections within the enforcement proceedings. To be effective, the mortgage needs to be registered with the competent land registry.

VI LEASES OF BUSINESS PREMISES

In Croatia, lease agreements can be concluded for a definite or indefinite term. In practice, the duration of lease agreements commonly varies from one to five years (and from 10 to 15 years for anchor tenants in shopping centres). Long-term lease agreements for 50 or more years – although not prohibited – are rather a novelty on the market. Early termination of the lease agreement by either the landlord or the tenant is possible for mandatory reasons stated in the applicable laws, or for reasons agreed by the parties to the lease themselves. For years, a lease was considered as being renewed for an indefinite period if the landlord did not oppose the tenant's continued use of the premises after the expiry of the original definite term of the lease. However, recently the Supreme Court has taken the view that such an automatic renewal does not apply to retail premises. It remains to be seen if this recent view will change the practice of Croatian courts in general.

If the landlord sells the premises during the duration of the lease, all rights and obligations towards the tenant are automatically transferred to the new owner. If, however, the leased property is sold in the course of enforcement proceedings to settle the landlord's creditors, the lease will not be binding for the new owner, unless it has been registered with the land registry prior to the commencement of the enforcement proceedings or prior to the security securing the claim that is to be settled within the enforcement proceedings. The tenant can register the lease agreement in the land registry if such a provision is included in the lease agreement. The tenant has no pre-emption right in the event of sale of the premises unless otherwise agreed in the lease agreement.

The parties to the lease are free to agree the rent. The rent should, however, be in line with market standards – otherwise there could be tax consequences. Generally, the underlying laws do not envisage a rent revision procedure – such a procedure has to be explicitly stipulated in the lease agreement. There are, however, certain exceptions: under certain conditions, the landlord is entitled to modify the rent to perform repairs of retail premises for the purposes of decoration or for reduction of energy and maintenance costs; the tenant is also entitled to ask for a proportional reduction of rent in certain circumstances (e.g., partial inability to use the premises).

Rent of business premises is subject to 25 per cent VAT, if the landlord is registered as VAT payer, while rent of residential premises is VAT exempt. Registration for VAT purposes is required if the value of total annual taxable supplies provided in the previous year exceeds 230,000 kuna (from 1 January 2018, the threshold will be increased to 300,000 kuna). Service charges are subject to VAT under the same conditions as the rent. The parties have to explicitly agree on service charges to be included in the rent.

The landlord is obliged to maintain the premises in such a condition that the tenant can perform the activity stipulated in the lease agreement. The landlord is also obliged to make any repairs necessary to that end. When a need for such repairs arises, the tenant has to immediately notify the landlord in writing, otherwise the tenant could be liable for possible damage. Major repairs (to structure, heating systems and the like) are also, in principle, borne by the landlord. The tenant on the other hand is obliged to bear the costs of usual maintenance such as cleaning, painting of walls, small installation repairs and similar, unless otherwise agreed, and generally to maintain the premises in the condition they were in at the beginning of the lease. The tenant cannot, however, be held liable for deterioration of the state of retail premises, devices and equipment resulting from their regular use. Upon termination of the lease agreement, the tenant is obliged to reinstate retail premises to the condition in which they were originally provided by the landlord, meaning that the tenant has to undo all alterations, unless otherwise agreed by the parties.

As from 1 January 2016, the landlord has to obtain a valid energy certificate for retail premises and has to deliver it to the tenant prior to entering into the lease agreement.

VII DEVELOPMENTS IN PRACTICE

i Principle of trust in the land registry

Croatia is a 'title registration' country, meaning that for a person to acquire title over a certain piece of real estate, the acquirer requires (1) a basis, usually an agreement intended to transfer title over such real estate from one person to another person; and (2) such a transfer to be registered with the competent registry, the land registry. Exempt from this rule are acquisitions that occur by virtue of the law or by virtue of a court decision or decision of another state authority. In such cases, title registration, although not material, is also highly recommended.

The above principle of title registration was, however, abandoned during the communist regime (practically, from shortly after the Second World War until the early 1990s). During that time, the majority of land was considered as being under social ownership and registered as such; privately owned land was an exception. Title registration was not required for acquisition of title and transfer of title was rarely registered with the land registry. During that time, the alternative registry – the cadastre registry – was used to collect and maintain data on possessors or occupants of real estate.

Because the land registry records were not fully up to date with the actual situation, the Act on Ownership and Other Rights *In Rem*, when it was introduced in late 1996, envisaged that the principle of trust in the land registry should not apply to real estate registered as being under social ownership with the competent land registry on 1 January 1997 (the date on which the Act on Ownership and Other Rights *In Rem* came into force). Originally, the application of the principle of trust in the land registry was postponed for five years (i.e., until 2002). That term, however, proved to be insufficient in practice, and was extended on several occasions, most recently in late 2014, at which time it was stated that the principle of trust should not apply to real estate title transfers that occur prior to 1 January 2017. The idea behind the postponement was to allow prior owners (1) whose real estate was nationalised or confiscated during the communist regime, or (2) who did not register their ownership during the communist regime, to do so after the entry into force of the new Act on Ownership and Other Rights *In Rem*, under certain legally prescribed conditions.

In practical terms, the fact that the principle of trust in the land registry does not apply, means that real estate due diligence is often more in depth than in other jurisdictions. Before any potential purchase of real estate, a purchaser has to review not only the actual land registry records (showing who is currently registered with the competent land registry as the owner of the target real estate), but also the historical land registry records (showing the transfer of title over the subject real estate from the currently registered landowner all the way back to 1 January 1997, to confirm whether the subject real estate was registered as being under social ownership on that date; and if so, all the way back to the last-known private owner before social ownership, to ascertain whether such a prior private owner, or any other third persons, may claim title over the subject real estate). In such cases, it is also usual to contact the authorities that are competent for restitution proceedings to inquire as to whether there are any ongoing restitution proceedings with reference to the real estate, based on claims for restitution of land that was nationalised or confiscated during the communist regime. Although such claims could only be raised up until the early 2000s, there are still a number of ongoing proceedings. Additionally, and considering the existing dual registries (land and cadastre registry), records of both registries should be reviewed before a potential purchase.

Notwithstanding the fact that that the land registry records are still not up-to-date, there was no further postponement in the application of the principle at the end of 2016 (i.e., the principle of trust in land registry applies for all real estate as of 1 January 2017). This lack of postponement, although surprising, is a positive sign. However, it remains to be seen how the principle will work in practice in relation to real estate that should be registered as property of the Republic of Croatia under the applicable rules, real estate that is still registered as social ownership and real estate that is still the subject of restitution proceedings.

ii Change in taxation

The change in the VAT/RETT regime introduced as of 1 January 2015 (where VAT applies to the transfer of construction land or buildings before their first occupation or use and RETT to the transfer of other buildings and agricultural land – as explained in Section V.iii, above) increased prices of construction land when sold to non-VAT payers. On the other hand, the 'new' system is beneficial to the purchasers, who are registered VAT payers, since they will deduct input VAT charged on sale of the construction land, while RETT, which traditionally has been a non-refundable real estate acquisition cost, will be eliminated.

iii Development and construction of real estate

Croatia enacted a new Spatial Planning Act and a new Construction Act in late 2013, which are applicable as of 1 January 2014 (and were amended in 2017). As with many other laws, the changes to these laws were triggered by, *inter alia*, a requirement to align them with EU law, once Croatia became an EU Member State.

In particular, the new Construction Act incorporates Directive 2010/31/EU of the European Parliament and of the Council of 19 May 2010 on the energy performance of buildings. In line with this Directive, the Construction Act requires the issuance of energy certificates for the majority of buildings; exempt from this obligation are buildings that will be used for two years or less, buildings that will be used for religious services, buildings having aggregate use surface of less than 50 square metres, industrial buildings, etc. Such certificates are to be obtained before issuance of a usage permit for a specific building. Additionally, a building owner, who is required to have an energy certificate, has to obtain such an energy certificate before selling the building or part thereof, and has to present the certificate to prospective purchasers, and in the event of sale, has to hand over the certificate to the successful purchaser of the building or part thereof. As of 1 January 2016, the aforementioned obligation of the building owner to obtain, present and hand over the energy certificate also burdens the owner in cases of lease and leasing of premises.

One of the additional reasons for the change in the underlying development and construction laws, was to simplify the permitting process in the midst of the financial crisis that strangled the construction sector. The main change was that the two-permit rule, under which permits were often required for development (the location permit) and for construction (the construction permit), was abolished. The new Acts introduce the rule that a location permit is required for development of a location solely in certain legally prescribed cases; the investor shall otherwise be entitled to develop and construct solely on the basis of a legally valid and binding construction permit. The procedure has been even more simplified by virtue of recent amendments of the relevant laws in 2017.

As the new Acts were introduced during the financial crisis, at a time when the construction sector had become almost non-existent, it is difficult to assess yet whether the new acts have indeed managed to simplify the proceedings. However, the construction sector has recently begun to recover and it is likely that positive impact of legislative changes will be clearly visible in the near future.

iv Reorganisation of the judicial system and moving to electronic business models within the public sector

Croatia is known as a country with a very slow judicial system, which has undoubtedly affected commercial business opportunities, as investors are somewhat wary of investing in a market in which they will potentially have to wait years for a dispute to be resolved. However, things have started to slowly move forward. Number of unresolved disputes has significantly decreased lately (e.g., in the period from 2013 to 2015, it decreased for 24 per cent compared to 2013).

This positive trend is most likely a result of a comprehensive reorganisation of the judicial system, which has been ongoing for a number of years now. The Ministry of Justice has introduced a number of measures over the years, with the goal of balancing the workload of the courts to allow for specialisation opportunities, harmonised or uniform court practice, reduced costs by reducing the delegation of cases, and the creation of a more optimal work process overall.

One of the good aspects of the reorganisation is the introduction of the E-File system, a process that was commenced late in 2008. E-File is a public portal allowing parties and their legal representatives web access to certain procedural information about court files. As of 2013 the E-File portal is supposed to cover all municipal, county and commercial courts in Croatia. This is a quick way to obtain information about the current status and movement of case files, without having to visit or otherwise contact the competent courts, which additionally lightens the courts' workload.

On a general note, the process of moving to electronic business models within the public sector is constantly in progress, thus making the communication with relevant authorities much easier and faster. For example, the Croatian Financial Agency (FINA) has a number of electronic services; among other things, it maintains the web register of real estate available for sale (within enforcement or bankruptcy proceedings), so every interested investor can easily access information on available real estate.

v Enforcement over real estate

As with other proceedings, enforcement over real estate in Croatia is a lengthy affair. Although the Enforcement Act envisages enforcement proceedings as urgent or summary proceedings, there is no general term or deadline for their completion. In the worst-case scenario, proceedings may be conducted over five years or more.

To simplify the enforcement process and to make it more transparent, certain amendments in this direction were introduced in the Enforcement Act in 2014 (as amended in 2016 and 2017). One of the major changes is that under the new regime the sale of the enforced real estate is conducted by the FINA and not the courts as before. The public auction is conducted as an electronic public auction, with specific and short deadlines for various actions in the sale process. As the FINA only recently began to conduct the mentioned electronic public auctions, it is yet to be seen whether it will make the sale process swifter and more transparent.

VIII OUTLOOK AND CONCLUSIONS

The consequences of the financial crisis are still being felt in Croatia. Apart from economic measures, government actions are also aimed at changing laws with a view to creating a transparent and efficient legal framework, which will encourage business investments. The change of laws is additionally triggered by the requirement to align Croatian laws with EU rules and regulations, and this trend is expected to continue in the next few years.

After being without a government for the better part of early 2016, a new government took the helm in late 2016 and immediately introduced a very ambitious policy package. Envisaged reforms include measures to increase the sustainability of the general state debt, promote the competitiveness and growth of the economy and introduce a sustainable and simple tax system. A comprehensive tax reform was pushed through quite quickly (applicable as of 1 January 2017), but the impact of the new rules is yet to be seen.

Chapter 11

DENMARK

Torben Mauritzen[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

Like Danish law in general, Danish real estate law is based on legislation rather than case law. Regulation is comprehensive covering surveying and registration of real estate; the registration and protection of rights in real estate; area planning; construction of buildings, including safety and energy efficiency; tenancies, pollution, tax valuations and real estate taxes; compulsory acquisitions and compulsory sales, etc. Moreover, real estate financing is subject to intensive regulation as part of Danish financial law, which to a wide extent reflects EU regulation.

ii System of registration

Real estate in Denmark is accurately mapped in a grid covering all Danish land that is made available and maintained by the Danish Geodata Agency. All rights in Danish real estate, including ownership, can be registered in the central Danish land registry, an electronic register that includes a section for each individual property.[2] The land registry is administered by the Danish courts.

All substantial rights in Danish real estate should be registered in the land registry, as such a registration made in good faith extinguishes existing, non-registered opposing rights, and protects the registered rights against future opposing rights. Among the rights that should be registered are title (ownership rights), mortgages and rights of use extending the rights according to the legislation on tenancies.

Moreover, public registers regarding buildings, ascertained pollution and pollution risk, tax valuations and area plans are maintained and are sources of information about Danish real estate. Private registers of real estate for sale and hire and of real estate sold are also available.

iii Choice of law

Investment in Danish real property is generally made through one or more Danish companies, normally a Danish holding company with subsidiaries each owning a single property or

1 Torben Mauritzen is a partner at DLA Piper. The information in this chapter was accurate as of February 2017.

2 Land with possible buildings, a building on leased land or owners' flats that include a share in the 'parent' property.

a group of properties. The structure creates a profit centre for each property or groups of properties and is tax efficient both when operating the property or properties and in the event of sale. This will be explained further in Section IV, below.

Direct investment in real property or investments through limited partnerships are also widely used. The limited partnership structure combines limited liability for the investor and taxation as if the investor had owned the property directly (the limited partnership is tax transparent). This will be elaborated on in Section IV, below.

Under Danish law, the parties are free to agree on any term and condition for the purchase and sale of Danish real estate, including that the transaction be governed by the laws of a country other than Denmark,[3] or that legal proceedings be instituted before the courts in a country other than Denmark or be resolved by arbitration. However, the parties should take into consideration that a number of legal issues regarding the real property, including registration and protection of rights, tenancies and public regulation, will be subject to Danish law and venue in any case.

II OVERVIEW OF REAL ESTATE ACTIVITY

The Danish real estate market has been divided in two since the gradual bursting of the Danish real estate bubble, which started in 2007 and culminated following the credit crunch. While transaction activity in the major urban and industrial areas in Denmark – including Copenhagen,[4] Aarhus[5] and the Triangle Region[6] – has been steadily increasing since the credit crunch, and in 2016 came up to pre-crisis levels, activity in the rest of Denmark remains low, and a number of properties in the peripheral regions are simply unsaleable and will inevitably have to be pulled down.

Through the Danish mortgage credit associations, financing of real estate is available at relatively low cost when compared internationally. However, because of the increased regulation of the financial sector following the credit crunch and the financial crises, and more careful lending policies, requirements for financial solidity in investments, including requirements for equity and sustainable positive cash flow from the target property, are strict. Normally, equity at 30–50 per cent of the investment will be required even if cash flow from the target property is clearly positive and the risk of vacancies or falling market rents is low.

In result, the Danish commercial real estate market is now dominated by players with deep pockets, including Danish pension funds, foreign and Danish real estate funds and high net worth individuals. In the attractive areas, especially Copenhagen and Aarhus, competition for high-quality real estate is high and prices have been increasing and yields decreasing accordingly. For the most attractive properties, yields down to 3 per cent are seen, even if there is no immediate potential for improving profitability. The purchase interest even at these yields is driven by professional investors seeking alternatives to investments in bonds generating yields at between 0.5 per cent and 2.5 per cent, which for the long-term bonds are combined with a substantial price risk.

3 Danish law includes, however, an ordre public rule, meaning that no agreement must infringe basic Danish principles of law.
4 The capital of Denmark situated on the island of Zealand and is by far the biggest city in Denmark.
5 The biggest city in Jutland, the Danish mainland – the western part of Denmark that borders Germany, as opposed to the Danish islands, the eastern part of Denmark including Zealand and Funen.
6 Industrial growth area in Jutland, including the cities Kolding, Vejle, Fredericia, Billund and Middelfart.

In debates about the health of the real estate markets in Copenhagen and Aarhus, the question about whether a new price bubble is being inflated has been asked. Until now, however, the answer has been no. In contrast to the market situation that existed before the bubble started to burst in 2007, (1) prices are based on actual yields not on speculation on quick resales at higher prices, (2) the yields are attractive in comparison to bond rates, and (3) the strict requirements regarding investors' equity ensure that most of the present investors will easily survive any possible new crises, including rising vacancies and falling rents. But it is obvious that investors should consider a scenario with rising interest rates and hedging the investment against such a scenario (e.g., by financing the investment with a mortgage loan based on long-term bonds).

III FOREIGN INVESTMENT

Traditionally, the Danish property market has been regarded as local and non-transparent by foreign investors, who have focused instead – as far as Scandinavia is concerned – on Sweden, especially Stockholm. The increased attention given to the safe harbour of politically stable and economically strong Nordic countries[7] has, however, drawn interest among foreign investors to Denmark – first and foremost to the Copenhagen region – and a number of foreign real property funds have been very active on the Danish real estate market in recent years and have made successful investments. In 2016 35–40 per cent of the transaction volume in Denmark could be ascribed to foreign investors. In light of this, Denmark cannot be regarded as a local market any longer.

Legally, the Danish property market has been – and still is – open for foreign investors, who in all legal aspects have the same standing as domestic investors.

However, investors domiciled outside Denmark[8] need permission from the Ministry of Justice to acquire real estate in Denmark, unless the investor is domiciled within the European Economic Area (EEA)[9] and needs the property as a permanent residence or the acquisition is a precondition for conducting business or delivering services.[10] As hiring out real estate constitutes service delivery, purchases of both commercial property and residential property for hiring out can be made by investors domiciled within the EEA without permission. For investors domiciled outside the EEA, permission for such purchases can be obtained. If, however, the purchase is made through a Danish company or other legal entity domiciled in Denmark, the rules and permission are in any case irrelevant.

It should be added that the rules effectively prevent investors, etc., domiciled outside Denmark from purchasing holiday houses in Denmark. As regards such houses, no exceptions for EEA-domiciled buyers exist, and in practice permission from the Ministry of Justice is not achievable. Moreover, the rules are complemented by rules also preventing Danish companies and other legal entities from purchasing such houses without permission. These rules and

7 Denmark, Sweden, Norway, Finland – Iceland is a fifth Nordic country but is disregarded in this context due to the reconstruction of the Icelandic economy following the financial crises.

8 Hence, the criterion is not nationality but domicile.

9 EU countries and EFTA countries (Iceland, Norway and Liechtenstein). Although not a member of the EEA, Switzerland remains a member of the EFTA and through bilateral agreements participates in the internal market.

10 The rules accommodate the requirement for free movement of workforce, goods and services within the European Economic Area.

practice are based on the agreement on Denmark's admission into the EEC.[11] The Danish government negotiated a reservation for fear of great demand for Danish holiday houses from the citizens of neighbouring EEC countries that would prevent ordinary Danes from purchasing a holiday house in Denmark.

IV STRUCTURING THE INVESTMENT

As noted in Section I.iii, above, investments in Danish real property are normally made through a Danish holding company with subsidiaries each owning a single property or a group of properties. The structure creates a profit centre for each property or groups of properties.

Moreover, the structure is tax efficient. The net income from the property will be subject to Danish corporate tax at the rate of 22 per cent for the subsidiary. If the Danish holding company owns 10 per cent or more of the shares in the subsidiary, dividends can be distributed from the subsidiary to the holding company free of tax.

The same applies to dividends from a Danish company to foreign companies that own 10 per cent or more of the shares in the Danish company, if the foreign company is (1) domiciled within the EEA, or (2) within a country with which Denmark has entered into a double taxation avoidance agreement (DTAA).[12, 13] However, if the foreign holding company is only a 'flow through' company for an ultimate owner in a tax haven (the beneficial owner), this owner becomes liable to tax in Denmark, and the tax authorities will request that 27 per cent withholding tax of dividends be paid by the Danish company.

If the foreign company is domiciled in a country with which Denmark has entered into a DTAA, including countries within the EEA, and the foreign company owns less than 10 per cent of the shares in the Danish company, withholding tax must be paid by the Danish company according to the relevant DTAA. A normal rate for withholding tax in these instances is 15 per cent of the dividends.[14] In any case, where withholding tax must be paid according to a DTAA, either the withholding tax should be credited in the foreign company's domestic taxes, or the foreign company should be able to reclaim the withholding tax from the Danish tax authorities.

If the foreign company is domiciled in a country outside the EEA with which Denmark has not entered into a DTAA, including tax havens, 27 per cent withholding tax of dividends must be paid by the Danish company.

When selling a property owned by a Danish subsidiary, the subsidiary can be sold as an alternative to selling the property itself. Such a sale of the subsidiary will be tax free for the owner. In selling the Danish subsidiary, any agreement regarding, for example, administration or maintenance of the property will be transferred with the Danish subsidiary to the purchaser. Normally the loan agreements, including agreements with Danish mortgage associations, will include change of control clauses. Accordingly, such agreements will not automatically be upheld in the event of sale of the Danish subsidiary. If the purchaser is well reputed and financially sound, the lender will, however, normally offer to uphold the loan

11 Denmark joined the EEC as of 1 January 1973.

12 Denmark has entered into DTAAs with most countries of the world.

13 It is a further condition that Denmark is obligated to waive or reduce taxation of dividends according to Directive 2011/96/EU or the relevant DTAA, which in general will be the case.

14 Corresponding with the Organisation for Economic Co-operation and Development's Model DTAA.

agreements. The sale of the subsidiary instead of the property also means that tax on capital gains in the subsidiary will not be released and there is no issue with registration in the land registry (the property will still be owned by the subsidiary), whereby registration duties[15] will also be saved.

If an investment has been made in residential property not divided into owners' flats,[16] sale of the property and the controlling interest in a company owning the property is subject to a pre-emption right for the tenants according to the Danish act on residential tenancy. If instead a holding company owning the company owning the property is sold, the pre-emption right does not apply. Therefore, a double-holding structure should be considered if investments are made in residential property that is subject to the pre-emption right for the tenants.

The costs of forming Danish companies (A/S or ApS)[17] and fulfilling financial reporting requirements, etc., are limited, and the number of Danish companies used in the structure has therefore little influence on the cost base for the investor.

In short, and in general, investment in Danish real property through Danish companies provides tax efficiency and flexibility if and when the investor wants to exit.

As an alternative to investing through one or more Danish companies, direct foreign investment in real property or investment through a partnership (I/S), a limited partnership (K/S) or a limited liability partnership (P/S) could be considered. By choosing any of these options, the foreign investor will become the tax subject, as the I/S, K/S and P/S are all tax transparent entities.[18] The foreign investor will be liable to pay tax in Denmark on the net income from the property,[19] including an obligation to calculate this net income on an annual basis and to file annual tax returns with the Danish tax authorities.

If the investor or owner is a foreign company, the tax rate for the net income from the property will be the Danish corporate tax rate of 22 per cent. If the investor or owner is a natural person, the tax rate will be between approximately 41 per cent and 56 per cent; however, by choosing the Danish tax scheme for private businesses, and keeping the income in the Danish establishment, the natural person will be able to defer all taxes above the corporate tax rate of 22 per cent until exiting the investment in Denmark.

By investing through a K/S or a P/S, the investor can create a corporate wall around the investment in Denmark and thereby limit his or her liabilities to the amount invested and to possible guaranties that the investor has given to mortgage credit associations, banks or other suppliers to the Danish property. However, as the investor – with the exception mentioned in footnote 18 – is the tax subject in these cases, he or she will not be able to curtail his or her liability in relation to the Danish tax authorities through the corporate wall.

15 1,660 Danish kroner plus 0.6 per cent of the highest of the purchase sum for the property and the public valuation of the property; see also Section V.iii below.

16 Other exceptions exist, although these are less important.

17 The public limited company (A/S) and the private limited company (ApS) are both subject to the same regulation, primarily the Danish Companies Act. However, as an A/S 'light', the ApS is subject to requirements that are less strict in some areas, including the minimum requirement for capital of 50,000 Danish kroner as opposed to 500,000 Danish kroner for an A/S.

18 However, in some jurisdictions, including the United States, the entities will not be regarded as tax transparent or the investor will have the option to choose if the entity is to be regarded as tax transparent or not (tick-the-box rules).

19 The property will form a permanent establishment in Denmark.

V REAL ESTATE OWNERSHIP

i Planning

Planning in Denmark is governed by the Danish Planning Act.[20] The planning authorities in Denmark are the Danish Ministry of the Environment and below that the Danish municipalities, of which there are 98.

According to the Planning Act, each area of Denmark is labelled as rural, urban or as a holiday-house area, and the land use depends primarily on this label. The options for building in rural areas are largely restricted to buildings and other facilities necessary for the farm units in the area. Similarly, the options for building in holiday-house areas are restricted to primarily holiday houses, camping huts, hostels and smaller shops, cafes and restaurants, and similar facilities aimed at the holidaymakers in the area.

Each municipality must develop a 'municipality plan', which must be updated at least every 12th year. The municipality plan must include a framework for the infrastructure in the municipality and the purpose and building density of each sector of the area. A local development plan, detailing the geometry and use of buildings under the municipality plan will normally be required for land development and the erection of new buildings. Such a local development plan will be prepared by the municipality, often in dialogue with the developer or investor owning or being willing to purchase the area to undertake the development works. However, political approval is in any case required, and final approval cannot take place until a public hearing has been held.

To protect the urban environment in the city centres and support a diversified supply of shops, the Planning Act includes restrictions on the development of shopping malls outside the city centres and on the size of shops. To protect an open and accessible coastline, the Act also includes restrictions on construction on and along the coast.

The use of property, including buildings, can – as far as the Planning Act is concerned – be changed within the limits set by the relevant municipality plan and, if such a plan exists, the local development plan for the area. To achieve changes beyond these limits, an addendum to the municipality plan or a new local development plan is required.

Besides the restrictions stated in the Planning Act, limits for land use are stipulated in a number of other acts, including the Nature Protection Act,[21] the Forestry Act[22] and the Act on Agricultural Property.[23]

ii Environment

Under the Act on Contaminated Soil,[24] the Danish regions map contamination and possible contamination of land on the basis of available information on the use of the land – both past and present – and on the basis of pollution studies. Such studies are, however, only carried out on land likely to be so heavily contaminated or so located that public health, including drinking water, or the environment is endangered. The registrations made by the Danish regions are publicly available.

20 Consolidated Act No. 1529 of 23 November 2015.
21 Consolidated Act No. 1217 of 28 September 2016.
22 Consolidated Act No. 1577 of 8 December 2015.
23 Consolidated Act No. 27 of 4 January 2017.
24 Consolidated Act No. 1190 of 27 September 2016.

The Environmental Protection Act[25] lays down the 'polluter pays' principle, which is repeated in the Act on Contaminated Soil. The principle implies that the polluter is liable to carry out, and pay the costs of, all measures necessary to prevent or clean up the pollution.

On the other hand, no one but the polluter can be ordered to clean up or pay for decontamination. This also goes for a subsequent purchaser of contaminated land. However, if such a subsequent purchaser wants to build on the land, he or she can be forced to carry out decontamination or measures to encapsulate the pollution to fulfil requirements in the building permit. Such requirements are normal in building permits for residential buildings, institutions or other buildings in which people will have longer stays, or with surrounding areas to be used as playgrounds or the like.

iii Tax

No transfer tax or stamp duty applies to the purchase of real estate or real estate financing.

However, all substantial rights in Danish real estate should be registered in the land registry, as such a registration made in good faith extinguishes existing, non-registered opposing rights, and protects the registered rights against future opposing rights.

To register rights in the land registry, the following registration duties must be paid:

a Registration of title to the property: 1,660 Danish kroner plus 0.6 per cent of the highest of the purchase sum for the property and the public valuation of the property.[26]

b Registration of mortgages on the property: 1,660 Danish kroner plus 1.5 per cent of the principal of the mortgage deed. However, if mortgage deeds previously registered on the property are cancelled simultaneously, the registration duties paid on such mortgage deeds can be deducted. The same goes for registration duties represented by duty mortgage deeds.

c Other rights, including rights of use: 1,660 Danish kroner.

When purchasing building land or new buildings, VAT, at 25 per cent, on the purchase sum must normally be paid.

iv Finance and security

In general, the Danish mortgage credit associations provide financing of Danish real estate at low costs, when compared internationally. Moreover, these associations normally offer a wide variety of loans, enabling the real estate investor or owner to choose (1) duration (up to 30 years), (2) short, medium or long-term interest rate, and (3) repayment profile (some loans are offered with grace periods of up to 10 years). Margins will normally be between 0.6 and 1.5 per cent depending primarily on the seniority of the mortgage, the assessed creditworthiness of the borrower, and the quality of the property. The loans are granted against mortgage security in the property, normally first mortgage. Mortgage credits can be granted up to a certain percentage of the market value of the property depending on the type of property: 40 per cent for land, 60 per cent for commercial buildings and holiday houses, and 80 per cent for residential houses and buildings. However, for credits beyond 70 per cent, the margins will be substantially higher than for credits below this level.

25 Consolidated Act No. 1189 of 27 September 2016.

26 However, if the property is purchased as a private home for the purchaser, the public valuation is irrelevant.

In view of the relatively low prices and wide selection of loans, Danish mortgage credit loans are the preferred source of financing for real estate in Denmark. Accordingly, most security granted over Danish real estate is first mortgages with Danish mortgage credit associations.

VI LEASES OF BUSINESS PREMISES

Leases of business premises are governed by the Danish Act on Business Rentals,[27] which provides for freedom of contract and, with a few exceptions, only comes into force to the extent that the parties have not deviated from it by their agreement or lease contract. This contrasts with rental of residential units, which is subject to intense, mandatory regulation under Danish law based on the lawmaker's assumption that residential apartments are a limited resource and that the tenant is the weaker contract party and needs protection.

In accordance with the freedom of contract, the rent for commercial premises can be agreed by the contract parties without restrictions. So can subsequent regulation of the rent. However, the rent or the regulation can be set aside by the courts under the Danish Act on Contracts[28] if the rent or the regulation is found to be unreasonable, but this option is very rarely used.

Furthermore, the following rules apply unless the parties have agreed otherwise: if during the contract period the rent proves to be materially higher or materially lower than the market rent (meaning the rent that a competent landlord and competent tenant would agree on), each of the parties is entitled to an adjustment of the rent to the market rent if he or she so requests. Such an adjustment, however, cannot take place until the later of four years following (1) the beginning of the contract period, (2) the most recent requested adjustment to market rent in the same direction as now requested, or (3) any negotiated adjustment of the rent or other material terms and conditions for the rental. The adjustment is made in equal steps over a four-year period.

Similarly, the following rules apply unless the parties have agreed otherwise: if real estate taxes or duties for the premises or its supplies of water, electricity, renovation, waste water disposal, etc., are changed, the landlord is entitled and obliged to pass on the cost increase or decrease to the tenant through a rent adjustment as of the date on which the change in taxes or duties takes effect.

Normally lease contracts regarding commercial property state that the rent will be regulated annually in line with inflation expressed by the net price index calculated and published monthly by Statistics Denmark. Often, the landlord will also try to include in the contract a minimum annual rent rise of 2 or 3 per cent, which was a harmless clause when inflation was well above these levels, but with inflation now close to zero, such a clause can create an imbalance in the rent level over time.

Almost without exception, lease contracts regarding commercial premises in Denmark will include an obligation for the tenant to pay for the internal maintenance of the premises in addition to the rent. The same goes for the tenant's consumption of water, heat, cooling, electricity and gas. The costs of these supplies will normally be included and distributed among the tenants in annual consumption accounts for the property.

27 Consolidated Act No. 1714 of 16 December 2010.

28 Consolidated Act No. 193 of 2 March 2016.

Moreover, it is becoming more and more common to include in lease contracts also an obligation for the tenant to pay for (1) the real estate taxes for the property; (2) the property insurance; (3) cleaning and maintenance of common areas in and outside the building; (4) consumption of heat, water and electricity in these common areas; (5) maintenance and renewal of doors, windows and gateways in the building; (6) operation, maintenance and renewal of heating, air conditioning or ventilation, sprinkler, elevator, alarm and other systems in the building; and (7) maintenance and renewal of water pipes, sewage, and electrical installations, all in addition to the rent. These costs will normally be included and distributed among the tenants in annual operation accounts for the property.

This leaves the landlord with only the costs for the maintenance of the building shell (except doors, windows and gateways) and the administration and financing of the property, providing a very predictable and stable yield from the property.

If the landlord builds or otherwise tailors the premises to the specific requirements of the tenant, the tenant will normally undertake between five and 12 years' security of tenure. If the tenant is to make material investments in the premises, the landlord will normally undertake similar security of tenure.

It should be noted that the Danish Act on Business Rentals to a wide extent protects a tenant from termination of the lease, even if the landlord has not undertaken security of tenure. Thus, as one of its very few mandatory rules, the Act states that the landlord can only terminate the lease contract for normal business premises in the following situations: (1) the landlord wants to use the premises him or herself and termination is fair, taking both parties' interests into consideration; (2) the landlord proves that demolition or alteration of the building means that the tenant must move out; (3) in spite of complaints from the landlord, the tenant or his or her personnel or his or her visitors by their behaviour cause insecurity, a health hazard or similar inconvenience for the property or those who legitimately come there; and (4) when material reasons make it particularly important for the landlord to be released from the lease contract and such release is fair, taking both parties' interests into consideration. Unless the contract stipulates a longer notice period, the landlord must give one year's notice in the first of these situations and three months' notice in the other three of these situations.

In addition to the above situations, the landlord can terminate the contract with immediate effect in the event of material breach of contract on the part of the tenant; for example, non-payment of rent or subleasing without permission. However, in both these cases, the landlord must first give notice, requesting that the breach be remedied and informing the tenant that the lease will be terminated if the request is not complied with.

If the landlord rightfully terminates the contract, he or she will be obliged to pay damages to the tenant including the tenant's costs for moving, unless termination takes place in result of breach of contract on the part of the tenant. If the value of the business that the tenant runs from the premises is dependent on the premises (e.g., a store dependent on the location of the premises), the amount to be paid by the landlord must include damages for loss of goodwill. If the value of the business run from the premises is not dependent on the premises, the obligation for the owner to pay damages to the tenant is not mandatory. Accordingly, in such cases, the parties can agree that no damages are to be paid to the tenant in the event of the landlord's termination of the contract, and such an agreement is practically a standard in Denmark.

VII DEVELOPMENTS IN PRACTICE

By an amendment to the Planning Act, dated 3 March 2015,[29] the former Danish government, led by the Social Democrats and with supporting parties, authorised the municipalities to include in local development plans the provision that up to 25 per cent of housing stock in an area should be social housing stock. In general, such provision will impose a loss on landowners, as building rights to social housing do not hold the same value as building rights to commercial buildings or residential buildings not meant for social housing. Furthermore, decisions according to the Planning Act are regarded as regulation without compensation under Danish Law, meaning that no compensation is achievable from the Danish state or municipality for the landowners. The new Danish government under the Liberal Party, which took office on 28 June 2015, however, said that it would repeal the authorisation (see also Section VIII, below).

As of 1 July 2015, the Danish legislation on residential leases has been amended. The most important amendments are as follows.

The landowner is now under an obligation to inspect the leased residences together with the tenant and make a report on the condition of the residence both when the tenant takes it over at the start of the lease term and when the tenant returns the residence at the end of the term. If the landlord fails to make the inspections and the reports, the landlord loses his or her claim against the tenant for maintenance and repair of the residence in connection with its return. As a result of this obligation, it is important for purchasers of residential buildings to check that the reports have been made and are handed over to the purchaser. Furthermore, owners of residential buildings must allocate resources to handling these inspections and reports.

Obligations for the tenant to return the residence in a freshly renovated condition (i.e., newly painted, with freshly varnished floors, etc.) is no longer valid even if the tenant took over the residence in such a condition. Now, the tenant is only obliged to maintain and repair the residence to the extent 'necessary'. This can give rise to discussions on the level to which maintenance and repair of the residence is to be performed. Furthermore, renovating costs may be imposed on the landlord, as the landlord may be forced to renovate each returned residence to a freshly renovated level to maintain the same rent as before when reletting the residence.

These amendments to the legislation on residential leases only apply to lease contracts entered into on or after 1 July 2015.

VIII OUTLOOK AND CONCLUSIONS

In November 2015, the new Danish government under the Liberal Party announced a plan, 'Growth and development in the whole of Denmark', with a number of suggestions to support growth in Denmark, particularly in rural areas, which are lagging seriously behind Greater Copenhagen and Eastern Jutland, having never overcome the effects of the financial crises. Among the suggestions was a liberalisation of the Planning Act to give the municipalities more freedom in their planning, and businesses and citizens more freedom

29 Act No. 221 of 3 March 2015.

to use and develop their properties. Among the specific suggestions was a withdrawal of the authorisation for municipalities to include in local development plans the provision for 25 per cent of the housing stock in an area to be social housing stock.

Following political negotiations, the government entered into an agreement 'Denmark in Better Balance' with parties representing a vast majority of votes in the Danish parliament, including the Social Democrats, in June 2016 to modernise the Planning Act and amend the Nature Protection Act. The main elements are:

a less interference from the government in municipal planning;

b more possibilities to develop areas along the coasts, including transfer of holiday house area to urban area, and the establishment of test projects for coast and nature tourism;

c more freedom to develop rural areas, including villages, farms and other business in such areas, for example, it will be made possible:
- to change the use of buildings no longer in use for their original purpose;
- for businesses in rural areas to expand their buildings by up to 500 square metres (m^2);
- for citizens to expand their houses up to 500m2; and
- for farmers to build what is necessary for the farm-production, in all cases without permission under the Planning Act;

d more consideration for manufacturing companies in the planning so that, for example, new residential areas are not laid out close to such companies, thus creating pressure for reduction of activity;

e freedom for the municipalities to allow for shops – except for supermarkets – without restrictions as to size, also in the city centres, and expansion of the maximum sizes of supermarkets to the following: Local supermarkets, including supermarkets in local malls: 1,200m^2 (expanded from 1,000m^2), supermarkets in areas to relieve the city centres: 3,900m^2 plus 200m^2 facilities for the staff (expanded from 3,500 plus 200m^2), and supermarkets in city centres and city malls: 5,000m^2 plus 200m^2 facilities for the staff (expanded from 3,500m^2 plus 200m^2). The actual prohibition against shopping malls or the like outside the cities will be upheld;

f minimum deadlines for objections during public hearings will be reduced from eight to four weeks for simple amendments to municipal plans and for local development plans;

g that the authorisation for municipalities to include in local development plans the provision for 25 per cent of the housing stock in an area to be social housing be maintained; and

h a decision to provide for a further expansion of Copenhagen Airport (CPH).

The bill implementing the agreement – except for the part regarding CPH – was presented to the Danish parliament on 25 January 2017, and it is expected that the bill will be passed in May 2017 and take effect as of 1 July 2017.

Chapter 12

ENGLAND AND WALES

John Nevin[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, long 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 250 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.

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

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been a dealing with the land that triggers a requirement for 'first registration'. 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. More recently, it also includes the purchase price at which the owner acquired the property and the date of purchase, if done so through an asset as opposed to a share purchase. 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. Owing to tax planning structures, property ownership vehicles are often incorporated in the Channel Islands.

II OVERVIEW OF REAL ESTATE ACTIVITY

The Prime Minister has confirmed that the UK will leave the EU on 29 March 2019. That much at least would appear to be certain. However, just about everything else in relation to Brexit remains unclear as the negotiations with the EU and the UK's trade partners continue. A poor result at the general election means that the Prime Minister does not have the 'stronger mandate' she had hoped for to drive through Brexit. Instead, a resurgent opposition and divisions within her own party have magnified the uncertainty. Although Brexit has undoubtedly had a negative impact on real estate activity, London and the regions have continued to attract overseas investment, notably from Hong Kong and the Asia-Pacific region generally. Brexit is undoubtedly an event of enormous significance, but it is important to consider it in the light of continuing global economic and political instability. In that context, whether the UK is within the EU or not seems unlikely to affect the attraction of the UK as a place to live and work and where investors wish to spend their capital. London's position as one of the very few true global cities is assured for the foreseeable future. Although Brexit will undoubtedly cause investors and occupiers to consider alternative locations, both in Europe and globally, the UK's dominant position in the global real estate market remains undiminished. In addition, overseas investors remain tempted by the continued weakness of the pound and the relatively robust state of the economy, as the UK remains open as a place to do business.

Take-up in the London office market has softened as businesses evaluate their post-Brexit strategies and requirements. Nonetheless, there have still been some significant deals, with Deutsche Bank committing to nearly 500,000 square feet of City space and Facebook confirming its search for up to 700,000 square feet of new space. A handful of large trophy lettings aside, the market is in the process of reinventing itself as the serviced office sector becomes part of the property establishment. A transition is occurring in the City as a more diverse occupier mix competes with the traditional financial and professional services sectors. The new wave of tech and media occupiers are looking for affordable, flexible and well-connected space with higher levels of service provision. The serviced office space boom has also extended to regional centres with a thriving tech and media sector, such as Manchester, Milton Keynes, Cambridge and Oxford.

The retail sector is in a state of flux as traditional retailers continue to go through the process of reassessing and redesigning their space requirements while online retailers have started to experiment with physical space to showcase their products and lifestyle aspirations. Shopping centres and retail parks are also evolving to offer a more general leisure experience with wider food and beverage and leisure activity offerings. The luxury central London retail market continues to benefit from the enhanced spending power of overseas visitors. Although there have been fewer retail insolvencies than last year, the secondary high street market remains oversupplied as it adjusts to the changing demands of consumers. Retailers have also been hit by the rating revaluation and inflationary pressure on wages and other costs. Demand from online retailers for increasingly large high-specification distribution centres has outstripped supply and boosted volumes in the logistics sector. The wider industrial sector remains mixed as favourable exchange rates have, to an extent, offset the uncertainty surrounding post-Brexit trade deals.

The alternative investment market continues to evolve and expand as overseas investors look beyond the traditional office, retail and industrial sectors. The private rented sector continues to be the most popular, and institutional investors have increased their market share. There has also been increased activity in the retirement living market, with the emergence of new luxury developments in central London, as well as the more traditional coastal retirement locations. The hotel sector has enjoyed high occupancy rates as overseas visitors take advantage of their enhanced spending power and the 'staycation' domestic market continues to grow. Investment in the sector has also been strong, with investors extending their interest beyond trophy hotels in the luxury central London market. Student accommodation, logistics, data centres and infrastructure have also continued to attract interest from overseas investors.

The slowdown in prime central London residential property has spread to the wider London market as inflated prices, oversupply, Brexit and punitive rates of Stamp Duty Land Tax (SDLT) have all contributed to a shortage of overseas and domestic buyers, although the recently announced SDLT relief for first-time buyers should boost the lower end of the market. Although interest rates remain extremely low, the recent increase to 0.5 per cent will not have helped confidence in a weak market. While London has struggled, the wider UK market has fared better and rising prices can be contrasted with stagnant or falling prices in the capital. Manchester has been a particular hot spot that has benefited from the relocation of both public and private sector jobs from London, the BBC's move to Media City in Salford being a prime example.

On the financing side, there has been a decline in loan origination for UK property, with banks in particular adopting a noticeably more cautious approach. However, alternative lenders have continued to increase their lending activity and market share. Significant new entrants in the non-bank lending market have included fund managers and insurance companies looking for relatively safe long-term returns.

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. The limited partnership regime has been modernised by the introduction of a new private fund limited partnership to help meet the needs of fund managers.

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 (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 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 and difficult to achieve.

vi Property authorised investment fund (PAIF)

PAIFs are open-ended investment schemes that invest in property and are authorised under FSMA. The PAIF regime allows gross dividends to be paid, and was introduced to make property attractive to tax-exempt investors. A number of conditions apply for entry into the PAIF regime, including the need to carry on a property investment business and the genuine diversity of ownership condition. PAIFs benefit from SDLT seeding relief.

vii 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.

viii 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.

ix 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.

x 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. 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 London-wide level, including the power to decide strategically important planning applications himself. Planning administration is governed by various statutes, the most important of which is 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 are automatically granted planning permission under the Town and Country Planning (General Permitted Development) Order 2015. 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 LPA planning decisions to the Secretary of State, in which case the Secretary of State will decide the application afresh and on its merits. Third parties have no such right of appeal but they (and applicants) can appeal decisions of the Secretary of State on the grounds of legal error. LPAs have enforcement powers to deal with development which is carried out without or in breach of planning permission. The Planning Act 2008 provides a streamlined decision-making process for nationally significant infrastructure projects, which are projects within the five general fields of energy, transport, water, wastewater and waste, as well as certain commercial and residential projects. A development consent order granted under the Planning Act 2008 provides a single consent for such projects, thereby removing the need for developers to seek planning permission and other related consents separately.

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 (in England) or Natural Resources Wales (in Wales) 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 United Kingdom 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

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 past three years, or an incomplete industrial or commercial building.

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 5 per cent in respect of that part of consideration which exceeds £250,000. Residential properties are subject to rates ranging from 2 per cent up to 12 per cent for higher-value properties where the consideration exceeds £1.5 million, and there is an additional 3 per cent charge on second homes and most buy-to-let properties. The Autumn Budget introduced a new relief for first-time buyers to help boost home ownership. Where the buyer of a residential property costing more than £500,000 is a corporate vehicle, the rate of SDLT is 15 per cent and an additional annual charge may also apply. A new land transaction tax will replace SDLT on property transactions in Wales with effect from April 2018. 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 usually assessed every five years, and a revaluation took place in 2017 based on 2015 rateable values. This has resulted in a significant uplift, particularly for those businesses in property hot spots such as central London. 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.

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. 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, complex and onerous for lessees. 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 250 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 recently. 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 if the lessor has exercised the option to tax.

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 (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 incoming 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 an existing lessee's guarantor cannot guarantee the liability of an incoming assignee, it can guarantee the outgoing lessee's obligations under an AGA given by that lessee in respect of the assignee. In *EMI Group Limited v. O&H Q1 Limited*,[3] the court confirmed that a purported assignment of a lease to the lessee's guarantor was void and of no effect. 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 without incurring any expense itself in relation to the property.

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.

2 [2011] EWCA Civ 904.

3 [2016] EWHC 529 (Ch).

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 (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 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 completed. Contracting out tends to be more common in relation to short-term leases. A recent reform ensures that lessees operating a business from home do not acquire security of tenure.

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 Vote to leave the European Union (Brexit)

Once again, it is hard to look beyond Brexit, and the ongoing negotiations with the EU, as the dominant topic shaping the political, economic and legal landscape. However, from a real estate perspective, the purely legal implications are much less significant than the effect on the real estate investment market. Land law in England and Wales is almost entirely unaffected by membership of the EU and Brexit will not have any direct legal implications for the way in which overseas investors own and deal with UK property. This can be contrasted with environmental law and policy where EU legislation has a significant role, including the environmental aspects of the planning process. Brexit will also have an impact on State aid and procurement, where public authorities are involved in real estate projects.

The government has confirmed that the UK will leave the EU at 23:00 GMT on Friday 29 March 2019. Once implemented, the European Union (Withdrawal) Bill (formerly known as the Great Repeal Bill) will bring the supremacy of EU law to an end by repealing the European Communities Act 1972. A Trade Bill will deal with the UK's trade agreements and policies and a Customs Bill will provide for a new standalone customs regime. The process of adapting existing EU law will undoubtedly continue for a number of years as the UK picks and chooses the EU-based law it wishes to go forward with.

ii Landlord's redevelopment works

The most common ground of opposition to a lessee obtaining a renewal lease under the LTA is the lessor's intention to redevelop. The lessor can oppose statutory renewal if it intends to carry out redevelopment works on the termination of the lease and requires possession of the property to do so. In *S Franses Ltd v. The Cavendish Hotel (London) Ltd*,[4] the High Court confirmed that a lessor satisfied the redevelopment ground where its intended scheme of works was designed purely to achieve vacant possession under the LTA. The key question before the Court was whether the lessor intended to carry out the works, and not why the lessor intended to do so.

Accordingly, the lessor's underlying motive is irrelevant provided that it can establish the necessary intention to implement the relevant scheme of works. In this case, the lessee occupied part of a building operated by the lessor as a London hotel. The lessor wanted to obtain vacant possession and devised a scheme of works designed solely for the purpose of preventing the lessee from exercising its statutory right to remain in occupation.

iii Refurbishment and rateable value

The Supreme Court has confirmed that a property undergoing redevelopment that is not capable of beneficial occupation only has a nominal rateable value. In *Newbigin v. SJ & J Monk*,[5] the ratepayer was carrying out substantial redevelopment works to its offices and sought to alter the rating list to classify the property as a building undergoing reconstruction with a nominal rateable value of £1. The Valuation Office Agency argued that the statutory presumption that the property was in a reasonable state of repair should apply, even where it was not capable of beneficial occupation. The Supreme Court adopted the principle of reality and held that the property was not capable of beneficial occupation and only had a nominal rateable value.

The decision is good news for property owners and occupiers carrying out redevelopment works, particularly in the light of last year's rating revaluation that has resulted in a significant uplift in business rates for many business occupiers.

iv Energy efficiency

The government has published guidance on the minimum energy efficiency standards (MEES) that are due to come into force in April 2018. The guidance gives an indication of how MEES will be applied, what energy efficiency works are required to be carried out by a lessor and the application of the exemptions. With effect from April 2018, a lessor will not be able to let a property unless it meets the required energy efficiency rating. The rating for a property is set out in its energy performance certificate. From April 2023, MEES will be extended to cover all existing lettings and not just new lettings. A limited number of exemptions may apply, for example, where all energy improvement works have been carried out and the property still

4 [2017] EWHC 1670 (QB).

5 [2017] UKSC 14.

does not meet the required rating, where the cost of the works exceeds the expected savings on energy bills over a seven-year period, where any required third-party consents for the works cannot be obtained or where the improvement works would reduce the market value of the property. In addition, MEES do not apply to short lettings (not exceeding six months) or long lettings (99 years or more).

The prohibition on the letting of substandard property is something that all lessors need to be aware of, and energy efficiency improvement works may need to be carried out if a new letting is to be granted or, with effect from 2023, if the property is to continue to be let. If a lessor lets a property in breach of MEES, there is a risk of enforcement action being taken.

v Penalties and leases

Under English and Welsh law, a contractual provision that imposes an onerous obligation on a defaulting party that is out of proportion to the value of the legitimate interests of the other party in ensuring compliance with the contract is known as a penalty and is unenforceable. The Supreme Court recently restated the law in relation to penalties in *Cavendish Square Holding BV v. Talal El Makdessi*,[6] and the decision was applied in *Vivienne Westwood Limited v. Conduit Street Development Limited*[7] in relation to a rent concession arrangement. The parties had agreed that the lessee was to pay a discounted rent. However, the concession would cease to apply if the lessee was in breach of any term of the lease and the full rent would become payable with retrospective effect. The lessee was late with a rent payment and the lessor sought to terminate the rent concession. This would have resulted in a significant uplift in the rent for a relatively minor breach of the lease. The Court decided that the condition to the rent concession was unduly harsh and was unenforceable as a penalty. Payment of the full rent by the lessee was out of all proportion to the detriment suffered by the lessor as a result of the lessee's breach.

vi Real estate practice

The third edition of the Standard Commercial Property Conditions (SCPCs) has been published. The SCPCs form the basis of most contracts for the sale of commercial property and aim to strike a reasonable balance between the interests of the seller and the buyer. The new edition offers a general update to reflect the changes in law and practice since the second edition, published in 2004. Typically, the SCPCs are amended by bespoke drafting negotiated between the parties to deal with the key commercial and legal issues on each particular transaction. Most contracts for the sale of residential property incorporate the Standard Conditions of Sale (fifth edition).

VIII OUTLOOK AND CONCLUSIONS

Brexit will of course remain the dominant political, economic and legal issue for the foreseeable future. The government has triggered Article 50 of the Lisbon Treaty and has confirmed its intention to leave the EU on 29 March 2019. Despite the continued uncertainty and political fallout, the outlook for UK real estate and the wider economy is more positive than many had feared. This cautious optimism depends, of course, on the progress made

6 [2015] UKSC 67.
7 [2017] EWHC 350.

with the negotiations and the reaction to any agreement reached. The continued availability of a skilled workforce is of fundamental importance to the UK economy and will be a key factor for businesses considering whether to maintain a substantive presence in the UK. In addition, the construction industry has been reliant on labour from Europe for a number of years. In short, any tightening of restrictions on immigration will impact on the UK's ability both to construct new buildings and also to attract businesses to occupy them. Competition from other countries should not be underestimated and Germany is likely to be the biggest European beneficiary of any movement of the financial services sector from London. In addition to German cities such as Berlin and Frankfurt, Amsterdam, Paris and Dublin are also seen as alternative destinations in Europe. There is also strong competition from further afield and London's true rivals remain global cities such as Hong Kong, Singapore and New York, all eager to exploit any weakness exposed by Brexit. However, to put this in context, there is at this stage no sense of a mass abandonment and even those businesses implementing a relocation strategy are likely to retain more than a token UK presence for the foreseeable future. In a global market, it is important to retain a sense of perspective as to just how significant Brexit really is in the context of other world events.

On the legal side, practitioners will be anticipating the Court of Appeal's take on responsibility for liability suffered as a result of fraudulent property transaction. In *Dreamvar (UK) Ltd v. Mischon de Reya LLP*,[8] the buyer's firm of solicitors was held to be liable for losses suffered by its client as a result of a purported seller's identity fraud. The firm's appeal will be heard in 2018. The updating of the Land Registration Act 2002 and other property law reform projects seem likely to be sidelined as parliament focuses on Brexit-related legislation.

The government must work hard to ensure that the UK remains competitive and investment in infrastructure is essential. Although a new runway at Heathrow was confirmed in 2016 as the preferred option for expanding the UK's aviation capacity, a final decision remains to be taken and a further consultation has been launched. As Crossrail (now known as the Elizabeth line) approaches completion, government backing for Crossrail 2 and the Northern Powerhouse Rail network is still awaited. The government also needs to address the UK's chronic housing shortage. The Chancellor has announced plans in the Budget to build 300,000 new UK homes a year and the Mayor of London has suggested that London alone needs to build 66,000 new homes every year to meet demand.

Although it is impossible to predict what the next 12 months have in store, the outlook is more positive than the prevailing mood following the outcome of the 2016 referendum. Overseas investors have continued to believe in the strength and resilience of London and the UK, suggesting that they have been able to look beyond Brexit when evaluating their investment strategies. Although risks remain, there will undoubtedly be opportunities as the picture of a post-Brexit world develops.

8 [2016] EWHC 3316.

Chapter 13

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 that is prohibited by the laws and regulations'. As an absolute right, it confers on the owner the use of the asset, the right to receive the fruits of this asset and the right to dispose of it.

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, lift areas). *Copropriété* is generally the legal regime used for residential housing. Decree No. 2016-1167 of 26 August 2016 implementing Law No. 2014-366 of 24 March 2014 created a national registry of *copropriétés* where all syndicates managing *copropriétés* should now be registered. This registration obligation is only applicable 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.).

Long-term leases such as the *bail à construction* and the *bail emphytéotique* are entered into for a term of 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. Recent legislation created specific kind of long-term leases conferring a right *in rem* for the

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purpose of developing residential housing (*bail réel immobilier* created by Law No. 2015-990 of 6 August 2015) or social residential housing (*bail réel solidaire* created by Ordinance No. 2016-985 of 20 July 2016).

Traditionally, French scholars consider that the kinds of rights *in rem* governed by French law was subject to a *numerus clausus* (i.e., that French courts could only recognised those expressly provided by statutory law). A recent decision of the French Supreme Court put an end to a long and controversial litigation to admit that parties could create *sui generis* rights *in rem* for a limited term.[2]

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.

French case law held that a conflict between two persons holding the same title on a property should be adjudicated in favour of the one who registered its title with the land registry in the first place. Section 1198 of the Civil Code resulting from the reform of law of contracts enacted by Ordinance No. 2016-131 of 10 February 2016 now provides that the title holder who registered first should be preferred only if it is acting in good faith.

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

French real estate investment has been very active in 2017, with a perceptible acceleration from May – a possible 'Macron effect' on general business from both domestic and international perspectives. Competition remains high on a large range of assets and markets resulting in very challenging cap rates on prime assets. Investors' funds and public savings are channelled into the real estate market mainly through French real estate investment trusts (REITs) and insurance companies, but investment funds are also active in the French market; these were still among the biggest players in 2017, together with foreign sovereign investment funds (Abu Dhabi, China, etc.), as well as pension funds or trusts (US Canada, UK) investing in joint ventures with reputable real estate players rather than directly and on their own.

2 Decision of the third Division dated 8 September 2016 (see also decisions of 31 October 2012 and 28 January 2015).

The low level of interest rates also sustains the trend for a high level of refinancing. The real estate finance market is becoming more and more borrower-friendly, with banking institutions competing to offer lower pricing and higher leverage for these transactions and also relying, where relevant, on insurance companies in club deals. Such higher leverage offered by banking institutions reduced the market share of mezzanine lenders.

It is worth noting the increase in the number of pan-European transactions in real estate and real estate finance in the past 36 months, especially in hospitality and logistics.

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 statistical or administrative purposes to the French central bank or to the French Economics Ministry (or both); however, exemptions from such declarations may apply. For this reason, the implementation of any declaration obligations must be reviewed on a case-by-case basis.

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. For instance, administrative declaration is not required for investment in real estate companies unless they carry out a construction or development business; statistical declaration is required for investment in real estate companies or real estate assets for value exceeding €15 million.

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 mainly comprise 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 that:

- 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 (subject to the conditions it complies with certain prudential ratios and is not restricted to qualified investors), or a form regulated by similar rules in the country in which they are incorporated.

Pursuant to Decree No. 2017-932 of 10 May 2017, those transactions that were subject to the requirement of a prior declaration with the French Economics Ministry are now exempted.

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 SIIC 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 for 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 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 French corporation tax or to an equivalent tax amounting to at least one-third of the French corporation tax on the distributions received. Such levy is not payable where tax-exempt profits are paid to entities that have an obligation to distribute 100 per cent of received dividends (e.g., French SIICs and OPCIs and foreign equivalents), where the shareholders of such entities that hold, directly or indirectly, more than 10 per cent of the dividend rights are subject to French corporation tax or to an equivalent tax amounting to at least one-third of the French corporation tax on the distributions received.

The 3 per cent contribution on dividends was struck down with retrospective effect by the French constitutional court (*Conseil constitutionnel*, 2017-660 QPC) on 6 October 2017, and will consequently be abolished by the next Finance Bill.

Companies electing for the SIIC regime are entitled to step up the tax basis of their eligible assets at a reduced tax cost (19 per cent corporation tax rate instead of 33.33 per cent), payable in four years.

iii OPCIs[3]

OPCIs are fully exempt from corporation tax, 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 for 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.

Distributions paid out of the tax-exempt profits of SIICs and OPCIs to French UCITS,[4] certain alternative investment funds or foreign equivalent entities are subject to a 15 per cent levy.

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)

3 In particular, OPCIs with simplified rules.

4 UCITS or 'undertakings for the collective investment in transferable securities' are investment funds regulated at European Union level.

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.

Law No. 2014-366 of 24 March 2014 (Law No. 2014-366) has been enacted to promote new principles of town planning with the aim of reducing the surface area used for the construction of new buildings.

In accordance with these new principles, the Law prohibits the local or inter-communal authorities to provide in a PLU for a maximum ratio of constructed area to ground area. The Law further provides that it shall prevail over any existing local PLU in this respect: any ratio provided for in an existing PLU is then immediately set aside without any need for a revision of the PLU by the local or inter-communal authority.

In addition, the rules allowing a natural zone to be opened to urbanisation have been strengthened, and the list of situations under which constructions that are not situated in the neighbourhood of pre-existing constructions are permitted has also been restricted.

Ordonnance No. 2015-1174 of 23 September 2015 allowed the recodification of the French town planning code. The recodification included, *inter alia*, new features in PLU content and provided for a new definition of the various possible uses of a building.

A project's compliance with these rules is assessed by the relevant authority for the building permit.

Planning permission can be challenged by interested third parties before administrative courts for non-compliance with applicable rules. JADE decree (*Justice Administrative de Demain*) No. 2016-1480 dated 4 November 2016 amends the processing of claims against planning permissions in several aspects including, *inter alia*, the acceleration of the process of request and the limitation of abuse of process. In addition, the French government is considering adopting a new national housing strategy intended, *inter alia*, to limit abuse of process.

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.[5] Classified facilities are subject to a specific regulation codified in the Environmental Code.[6]

To validly operate such a facility and depending on its classification level, the proposed operator must either file a declaration or a registration or apply for authorisation (the new environmental authorisation[7]), 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

5 This encompasses a wide variety of equipment or premises ranging from air-conditioning systems to warehouses and factories whose operation involve handling hazardous substances.

6 Sections L511-1 et seq.

7 Sections L181-1 et seq.

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.

Under Law No. 2014-366, the seller of a property located in an area identified by a public authority as having been exposed to pollution must provide the purchaser with the information pertaining to such exposure collected from the public authority. If the seller fails to provide this information, and if the ground happens to be contaminated in a manner that results in the sold property not being fit for its proposed use, 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. This obligation (except for the cleaning up) is also applicable to lease agreements.

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, the operator may be held liable from an administrative, civil or criminal standpoint.

When a classified facility ceases its activities, the local authority orders the most recent operator to conduct environmental investigations and will issue an administrative order to clean up the site according to the results of these investigations.

Note that when pollution is discovered on a site, the administration will require the most recently registered operator of the site to clean it up or, if this pollution is generated by a neighbouring facility, the most recently registered operator thereof. Under Law No. 2014-366, if no registered operator can be identified, the administration can order the owner of the polluted property to carry out the cleaning, to the extent it can be demonstrated that the owner has been negligent in this respect or is to some extent related to the pollution.[8] The level of exposure of the owners to this new legislation will depend on whether the French courts will broadly or strictly construe these new criteria.

If pollution coming from the site's underlying ground generates damages to a third party, the 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*.[9] 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.

Under Law No. 2014-366, upon cease of operation of a classified facility, subject to approval of the last registered operator of the site and the relevant authority, an interested third party can substitute the former in order to carry out rehabilitation measures on site.[10]

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[11] governing the holding and handling of hazardous waste may impose obligations upon the owner of a property.

Especially where the owner of land carries out the construction of a building requiring prior excavation of polluted soil, the owner is liable for the proper handling of excavated soil

8 Section L556-3 II 2.

9 Literally, 'keeper of the pollution'.

10 Section L512-21.

11 Sections L541-1 et seq.

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 nature and level of pollution detected in the handled waste). Under Law No. 2014-366, the owner of a polluted property can be held liable if it can be demonstrated that the owner has been negligent to some extent or is to some extent related to the pollution, even if the owner did not actually take part in the construction of a building on the property.

iii Tax

Sales of development land (i.e., land 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 of 20 per cent has been in place since 1 January 2014).

Sales of land that cannot be considered as development land and of old buildings are exempt from VAT; however, the seller can always elect to pay VAT.

Sales of buildings also trigger a transfer tax amounting to 5.81 per cent 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 land;

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.

With effect from 1 January 2016, an additional tax of 0.6 per cent of the value of the asset applies to the sales of offices, business premises and storage premises located in the Ile-de-France region. Sales of new buildings are not within the scope of this additional tax.

In addition, for any sale of real estate property in France, a fee amounting to 0.1 per cent of the value of the asset is due, and the notary charges a 0.814 per cent fee (which can be reduced in certain cases).

Sales of shares in real estate companies (whose assets mainly consist of French real estate) are subject to a 5 per cent transfer tax based on the sale price or, if higher, on the fair market value of the shares.

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 legally possible to subject a lease entered into with professionals to the commercial lease statute.

Law No. 2014-626 of 18 June 2014 (Law No. 2014-626) provided for a quite significant reform of the French commercial lease statutory regime. Law No. 2014-626 has been supplemented by Decree No. 2014-1317 of 3 November 2014 (Decree No. 2014-1317).

ii Duration

In principle, the duration of a commercial lease must be 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. Since the passing into law of Law No. 2014-626, the tenant may no longer contract out of this right, except in cases of leases pertaining to offices alone, premises constructed for one single purpose (e.g., clinics, cinemas) or warehouses. On the contrary, the tenant may always 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 otherwise.

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 or, since the entry into force of Law No. 2014-626 and at least when delivered by the tenant pursuant to Law No. 2015-990 of 6 August 2015, notified by registered letter with an acknowledgment receipt 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 cases (as a result of the implications regarding 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), the 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 provisions governing the revision of the rent amount under a commercial lease have been amended to include an absolute cap that would be applicable to any judicial revision. Accordingly, the implementation of the rules governing the judicial rent revision may no longer result in an annual increase of the rent exceeding 10 per cent of the most recently passed rent of the lease.

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. The Construction Cost Index (ICC Index) is no longer available for rent revision under a commercial lease: instead, the Commercial Rent Index (ILC Index) is available for commercial activities, and the Tertiary Activities Rent Index (ILAT Index) is available for tertiary or professional activities or warehouses. 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 most recent contractual or judicial setting. The same absolute 10 per cent cap as that applicable to a judicial review triggered by a change in the rental value is also applicable to that kind of revision.

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 evidence of a significant change in one of the elements that served as the basis for the initial setting of the rent). In any event, even in the case of significant change in the above-mentioned elements, the 10 per cent cap shall be applicable to the rent upon renewal. 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 most recently passed rent of the renewed lease.

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 but French case law recently held that, when the rent consists of a fixed component and a turn over based variable component, the parties could validly refer the determination of the fixed component to the judge upon renewal pursuant to Section L145-33 of the Commercial Code.

vi Mandatory limitation on rechargeable service charge

The Civil Code provides some rules with respect to the allocation of service charges, and works and repairs obligations, between landlord and tenant. Such rules are applicable to all types of leases (i.e., they are not specific to commercial leases) but are not mandatory: parties may agree otherwise on such allocation.

Law No. 2014-626 (supplemented by Decree No. 2014-1317 on this matter) changes the above-mentioned principle for commercial leases, and lists some service charges and repairs that can no longer be rechargeable to commercial tenants. This mandatory limitation is a revolution in French market practice, where triple net investors' leases had previously been drafted and negotiated under the assumption that tenants should bear all charges and repair costs. The cost of heavy repairs (within the meaning set forth in Section 606 of the Civil Code), property management fees and some taxes levied on the owner (subject to exceptions such as land tax) can now no longer be recharged to tenants.

vii 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.

On the other hand, a pre-emption right is conferred upon the tenant under a commercial lease in the event of a sale of the rented premises pursuant to Law No. 2014-626, but only where the rented premises are used for retail.

viii 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 Reform of French law of contracts

The draft ordinance we referred to in the previous edition of *The Real Estate Law Review* has been enacted into Ordinance No. 2016-131 of 10 February 2016 providing for a large reform of the provisions of the Civil Code governing the contracts, the regime of obligations (whether contractual or not) and the rules of proof.

The Ordinance came into force on 1 October 2016. Even if to some extent, the intent of the French government was to embody into the Civil Code a large set of previous rulings of the French case law, the Ordinance provides however some innovative solutions. It is rather challenging to try to summarise the main provisions of this reform within the framework of this contribution; some of the main new rules that shall impact the real estate practice are as follows.

Mandatory duty to provide pre-contractual information

New Section 1112-1 of the Civil Code provides that whenever a party knows information which is of critical importance for the consent of the other party, the former should made the latter aware of that information where the latter party legitimately ignores such information or relies on the former party. Such duty does not apply to the value of the services or obligations. The duty to inform is mandatory.

Preferential right to contract

New Section 1123 of the Civil Code sets forth the regime of any preferential right to contract as this regime has been drawn by previous French case law. In particular, in case of breach of such preferential right, its beneficiary can apply for nullity of the contract entered into with a third party and for its substitution for such third party provided that the beneficiary can evidence that such third party knew the existence of the preferential right to contract and the intention of its beneficiary to exercise it.

Unilateral promise to contract

New Section 1124 of the Civil Code is reversing the controversial though continuing French case law as to the enforceability of a unilateral promise to contract. So far, if the promisor was retracting its promise before the beneficiary exercises its option to contract, the latter could only be awarded damages but could not apply for specific performance. The rule is now that a retraction by the promisor shall not prevent the beneficiary from exercising its option to contract and then the promised contract from being entering into.

General conditions of non-negotiated contracts

New Section 1110 of the Civil Code provides for a distinction between those contracts which have been actually negotiated between parties (*contrats de gré à gré*) and those whose general provisions have not been subject to a negotiation between parties (*contrats d'adhésion*) and new Section 1171 of the Civil Code further provides that, in the latter kind of contracts, any clause that appears to be significantly unbalanced shall be regarded as null and void. The definition of *contrats d'adhésion* already raised some controversy and the practice of general and often non-negotiable terms in commercial leases (in shopping centres for instance) should no longer be recommended.

Unforeseeable change in circumstances

New Section 1195 of the Civil Code adopts a rule that had been banned a long time ago in private contracts by the French Supreme Court (whereas the French Administrative Supreme Court admits it in administrative contracts). A significant change in circumstances resulting in the performance of a contract becoming excessively onerous for a party that did not accept to assume such risk shall entitle such party to a renegotiation of the contract and, failing to reach an agreement with the party, to apply before the court for a revision or a termination of the contract. The new rule (as most of those resulting from the reform) is not, however, mandatory and the parties can accordingly agree otherwise.

Connection between contracts

New Section 1186 of the Civil Code provides that a contract may cease to exist and to be enforceable (caducité) if its performance is rendered impossible by the disappearance of another contract.

Pre-emptive exceptio non adimpleti contractus

New Section 1220 of the Civil Code provides that when it becomes obvious that a party shall not be in a position to perform its obligations, the other party, even before the breach actually occurs, may suspend the performance of its own obligations.

Restrictions to specific performance

Curiously the same new Section 1221 of the Civil Code governing the contractual remedies both acknowledge that the specific performance is now the principle compared to damages and provides for a restriction to this principle where specific performance would trigger for the debtor costs manifestly not commensurate to the interest for the creditor. Alternatively, new Section 1223 of the Civil Code provides that the creditor of an obligation that has not been properly performed may apply for a price reduction.

Unilateral termination

New Section 1226 of the Civil Code provides that, in case of breach of contract, the non-defaulting party may unilaterally terminate the contract at its own risk by sending a simple formal notice to the defaulting party, even if there is no specific termination clause provided in the contract.

ii 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 variations (formerly in the ICC Index) in the ILC Index or the ILAT Index, which are both published quarterly by the National Institute of Statistics and Economic Studies.

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 logistics warehouses.

Need for clarification on rent indexation clauses

In 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 policy regulations applying to indexation clauses in general. A legal clarification of the indexation regime is expected to put an end to this situation of legal uncertainty.

To mitigate the consequences of a massive increase of the ICC Index on the level of commercial rents in 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 in breach of general public policy 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 these 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 above-mentioned 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. The appellate court ruling was upheld by the French Supreme Court in a decision rendered on 11 December 2013.

On the top of that, in an important decision dated 14 January 2016, the French Supreme Court finally held that the upwards only indexation were not valid. Since then, lower courts have rendered a significant number of decisions that tend to expand the scope of prohibition of any indexation formula not strictly keyed to the variations of an authorised index.

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[12] forum. This forum comprises a set of political meetings held in France between September and October 2007, which were 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, 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 the 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;

12 Grenelle de l'environnement.

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, is 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 an 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 Introduction of EU Directive on Alternative Investment Fund Management (the AIFM Directive)[13] into French law

A set of laws, including Law No. 2014-1 of 2 January 2014, introduced and implemented the principles of the AIFM Directive into French law.

An alternative investment fund is an entity that does not qualify as a UCITS, and is designed to collect equity from various investors with the purpose of investing such equity in a predetermined investment strategy implemented by a management company. Many investment vehicles set up to invest in real estate property or in real estate debt may fall within the scope of this rather broad definition.

Some criteria that need to be tested to determine whether the AIFM regulation is applicable to an investment vehicle are still to be clarified (e.g., what level of discretion is given to the management company in making investment decisions to qualify the vehicle as an alternative investment fund?). Companies running an industrial or commercial activity are exempted from the AIFM regulations; however, the question remains as to what extent a real estate activity can be regarded to be a commercial activity.

The French regulator, the Financial Markets Regulator (AMF), has already provided some guidelines to construe the new legislation, but to date no specific cases or litigation have been brought before the AMF or French courts.

There is some expectation as to what the interpretation of the above-mentioned criteria by the AMF and French courts will be to really understand the extent to which the AIFM regulations will now govern real estate investment business, which has so far been rather accustomed to developing in a non-regulated environment.

13 EU Directive 2011/61/EU of 8 June 2011 on Alternative Investment Fund Management.

v 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 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. 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). Pursuant to Ordinance No. 2017-1432 of 4 October 2017, which came into force on 3 January 2018, certain qualified debt funds may now be eligible to benefit from Dailly Law security assignment. Surprisingly though, insurance companies have not been retained as eligible.

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).

Deals involving mezzanine lenders have also raised some new challenging structuring issues in the world of real estate financing, such as when the mezzanine lenders' rights are subordinated to those of the senior lenders' rights as to the enforcement of common security (including mortgages) conferred upon both categories of lenders.

VIII OUTLOOK AND CONCLUSIONS

Better prospects in the growth of the French economy on trade and manufacturers may result in boosting the leasing transactions market for real estate investors, slightly shifting the negotiation power from tenants to investors. Accordingly, French real estate continues to be seen as a very attractive investment in Europe, and the combination of close-to-zero interbank interest rates and lower spreads makes credit even cheaper and encourages higher pricing of assets and lower yields on prime assets.

As most of the recent reforms of 2013 and 2014 in commercial property law, town planning and even investment management regulation have now been completed and assimilated into real estate market practice, legal practitioners are now facing a dramatic reform redrafting all general provisions of the French Civil Code relating to contracts enacted by Ordinance No. 2016-131 of 10 February 2016. As anticipated, the new rules give more discretion to judges when interpreting and implementing contracts. Accordingly, the impact of this reform shall largely depend on how the French courts will implement it.

Chapter 14

GHANA

NanaAma Botchway[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

Ghanaian real estate law combines common and customary law concepts. The vast majority of land in Ghana is still communally owned by stools (stools indicate status, power and succession of chiefs and kings), but a significant amount of land was compulsorily acquired by the state in the colonial and post-colonial era, and some lands are owned by natural persons.

The highest interest in land under Ghanaian land law is the allodial interest. This interest, derived from customary law, is absolute and paramount over all other interests in land and although it is theoretically capable of being held by an individual, it is typically held by a stool, a family or by the state. Title in such lands is usually held by the chief of the stool in trust for the stool or by the family head in trust for the extended family. The allodial holder's rights exclude certain rights that are vested in the president such as the right to exploit rocks, minerals, ores and fossil fuels found in, under or upon the land.[2]

The second highest interest in land is the freehold. The law recognises both common-law and customary law freeholds. The common-law freehold is the most common form of freehold interest in Ghana outside of the rural areas. As is the case in most common-law jurisdictions, the owner of the freehold may exercise most of the rights of ownership over the land for an indefinite period, excluding the rights indicated above in relation to rocks, minerals, ores and fossil fuels. The customary freehold historically acquired by a member of a community through exercising acts of ownership over vacant communal land still exists but is not that common, and although it may be conveyed for value, the acquirer of such land acquires a common-law freehold interest, not a customary freehold.

Leasehold interests predominate in Ghana. Leaseholds may be held individually or communally and by both natural and legal persons. The tenor of leasehold interests that may be conveyed is restricted to 99 years for Ghanaian citizens and 50 years for non-citizens.[3] As such, foreigners and legal entities, even Ghanaian-registered or wholly owned entities (as citizenship is not conferred upon legal entities) are only legally entitled to leases of up to

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2 Minerals and Mining Act 2006 (ACT 703), Section 1; Petroleum (Exploration and Production) Act 2016 (919), Section 3.

3 Constitution of the Republic of Ghana 1992, Article 266(4).

50 years. Most leases are common-law leases that entitle the holder to exercise most of the rights of ownership over the land for a defined term, subject to the leaseholder acknowledging the superior title of allodial or freehold title holder.

Lesser common-law interests in land such as easements and licences are also recognised under the law, as are customary law arrangements such as sharecropping rights.

ii System of registration

Most interests in land (allodial, freehold, leasehold interests with an unexpired term of two or more years and easements)[4] are registrable with the Lands Commission either under the Land Title Registration Act 1986 (PNDCL 152) or the Land Registry Act 1962 (Act 122). Certain areas within the country have been designated as registration districts and all holders of registrable interests in land situated in these areas must register their interests under the Land Title Registration Act. Currently, the Greater Accra Region[5] and parts of Kumasi[6] in the Ashanti Region are the only designated registration districts in Ghana. The minister in charge of lands may, however, by a legislative instrument, declare any other part of Ghana as a registration district.[7]

Registrable interests under the Land Title Registration Act include allodial, freehold and leasehold interests in respect of lands situated in registration districts.[8] Registration under the Land Title Registration Act confers indefeasible title,[9] namely, title that is free from all adverse claims but subject to encumbrances indicated in the register and certain overriding interests provided in the law. By comparison, registration of an instrument under the Lands Registry Act does not confer title, it simply constitutes notice of the instrument and provides evidence of priority of instruments based on the dates of registration.[10]

The process of registration under the Land Title Registry consists of the completion of a form, the payment of a registration fee and the submission of stamped copies of the documents submitted for registration. Site plans prepared by licensed surveyors must be attached, as well as any required consents. Once the documents are submitted, the administrative process, which includes plotting and entering the interest in the register, public notification of the application and issuance of the certificate, can take anywhere from four months to over a year. The process of registration of an instrument in the Deeds Registry involves many of the same steps as above, but it takes much less time and can be completed within three to six months.

4 PNDCL 152, Section 19(1).

5 Land Title Registration – Declaration of Registration Districts (Accra District) – the registration districts in Accra were created under multiple legislative instruments issued by the Minister of Lands and Natural Resources at various times.

6 Land Title Registration – Declaration of Registration Districts (Kumasi District K. 1) Instrument 1994 (LI 1590).

7 PNDCL 152, Section 5.

8 Only leasehold interests with an unexpired term of two or more years are registrable under the Land Title Registration Act. PNDCL 152, Section 19(1)(d).

9 PNDCL 152, Section 43.

10 Act 122, Section 25.

iii Choice of law

The courts in Ghana apply the doctrine of *lex situs* in disputes relating to immovable property located in Ghana.[11] As such, in the resolution of disputes relating to land situate in Ghana, the laws of Ghana shall apply.

II OVERVIEW OF REAL ESTATE ACTIVITY

The growth of the real estate sector in line with most of the services sectors remained fairly flat in 2017. The high-end residential market slowed, with occupancy rates in luxury apartment developments declining and rents coming under significant downward pressure. With a rapidly growing middle-class, rapid and uncontrollable urbanisation and a projected housing total of 2 million by 2018, the middle- and low-income housing market received more attention and is expected to continue to be an area of focus in the near- to medium-term as the government seeks to actively improve the sector for investors with various measures, including a new proposal to fund affordable housing, along with the repeal of value added tax (VAT) on property sales.[12] The year 2018 sees the development of significant middle-income property developments such as Appolonia City, a master planned development located on the outskirts of Accra, and the US$200 million Saglemi Affordable Housing development in Prampram, funded by the Emerging Markets Fixed Income Division of Credit Suisse. In October, the government also announced a collaboration with the Social Security National Insurance Trust to develop 2,000 affordable housing units in the Ashanti region.

The commercial real estate market also saw weakened demand as a result of the recent economic downturn and relatively high rents.[13] As a result, rents came under some downward pressure because of rising vacancy rates and the limited number of tenants seeking space.[14] The year 2017 saw the completion of some significant projects such as Dream Realty's Octagon, a 36,000 square metre retail, office and hotel development, and a number of flagship head offices by banks such as the prominent 22,000 square metre Ecobank head office building, the Cal Bank Head office and the Zenith Bank head office. Work commenced on The Exchange, a mixed-use development that includes over 12,000 square metres of retail space, a 200-key four-star hotel as well as a number of premium residential apartments. The Marine Drive Project, a 241 acre, US$1.2 billion, 10-year phased project for the redevelopment of the Accra waterfront to include new hotels, malls, office and residential facilities was officially commenced with the sod-cutting by the President of Ghana in late December.

III FOREIGN INVESTMENT

Foreigners are permitted to invest in land in Ghana, but the nature and extent of the interests that they are permitted to own is restricted. Under the 1992 Constitution, any person who is not a Ghanaian citizen may not hold a freehold or higher interest in land in Ghana.[15] Any

11 *Davis v. Randall and Another* [1963] 1 GLR 382–386.

12 The 2018 Budget Statement and Economic Policy of Government: http://citifmonline.com/wp-content/uploads/2017/11/2018-Budget-Statement.pdf, last accessed 6 December 2017.

13 Knight Frank's 2017 Africa Report: Real Estate Markets in a Continent of Growth and Opportunity: http://www.knightfrank.com/africareport, last accessed 6 December 2017.

14 Knight Frank's 2017 Africa Report: Real Estate Markets in a Continent of Growth and Opportunity: http://www.knightfrank.com/africareport, last accessed 6 December 2017.

15 1992 Constitution, Article 266(1).

agreement that purports to convey a freehold interest to a non-citizen is void.[16] Foreigners and legal entities, whether or not wholly owned by Ghanaian citizens, may therefore only hold leaseholds and lesser interests in land.

Additionally, any person who is not a Ghanaian citizen may not hold a leasehold interest for a term of more than 50 years at any one time.[17] Any such any agreement, deed or conveyance that purports to confer a leasehold for a term exceeding 50 years over land in Ghana will be reduced to a 50-year term. There are no specific incentives available to investors in relation to land ownership in Ghana.

IV STRUCTURING THE INVESTMENT

Most major real estate investments are structured using special purpose vehicles incorporated in Ghana. The entity of choice is the private company limited by shares. This entity has the advantage of limiting the liability of the investor to the investment in the company's shares, but also the disadvantage of being tax inefficient because it has a separate legal personality for tax purposes. With corporate tax rates at around 25 per cent, this disadvantage is not insignificant; however, in the absence of any other entities often used in real estate investments around the world, such as limited partnerships, S corporation or US limited liability companies, the Ghanaian limited liability company is basically all that there is. Although partnerships are in theory available, because only natural persons are permitted as partners, along with the absence of any protection from liability, this makes the partnership an unattractive option notwithstanding its relative tax efficiency. Similarly, trusts are not used very often in Ghana because the trust law is antiquated and the relative lack of legal precedent on the operation of trusts and the rights and obligations of trustees makes them unattractive from an investment standpoint.

Private limited liability companies may have no more than 50 shareholders and may be either partly or wholly foreign owned. Under the Ghana Investment Promotion Centre Act, foreigners are required to invest certain minimum amounts of capital in limited liability companies. If the company is jointly owned by Ghanaians and foreigners, the foreigners are required to invest a minimum of US$200,000 in cash or in kind in the entity. If the entity is wholly foreign owned, the foreign owners are required to invest a minimum of US$500,000 in cash or in kind. The investment must be transferred into Ghana from abroad and, if paid in cash, must be converted into Ghana cedis. Once converted, the investment amount may be used as working capital.

Ghanaian company law permits the creation and issuance of a variety of securities by limited liability companies, but investors typically only issue ordinary shares, referred to as common shares in other jurisdictions and occasionally, preference shares. Ordinary shares are issued with no par value and different classes may be issued. Subject to certain limitations, different governance and other rights may be granted to shareholders within the same class. Interest-bearing shareholder loans are permissible and are subject to thin capitalisation and transfer pricing regulations.

Investors in limited liability companies may be natural persons or legal entities. Foreigners are permitted to act as directors and there is no requirement that any directors in a company be Ghanaian; however, at least one director must be in Ghana at all times.

16 1992 Constitution, Article 266(2).

17 1992 Constitution, Article 266(4).

The process of incorporation of a limited liability company takes about two weeks. All would-be shareholders and directors in a limited liability company are required to register with the Ghana Revenue Authority and be issued with tax identification numbers. Following incorporation, the company must be registered with the Ghana Investment Promotion Centre before it commences operations. This registration process typically takes no more than two weeks.

The special purpose vehicles used are typically asset holding companies that are operated by a parent, affiliate or third-party company under an asset management agreement or similar arrangement. These agreements are subject to transfer pricing regulations, and where they are entered into with a foreign asset manager, the certain terms in the agreements may be subject to further regulation and registration with the Ghana Investment Promotion Centre.

V REAL ESTATE OWNERSHIP

i Planning

Zoning plans and schemes exist that are supposed to guide the development of each locality in Ghana. In practice, however, there is limited compliance with the zoning rules in many areas, particularly in Accra, which has resulted in the proliferation of commercial, residential and light industrial developments, all within areas earmarked for residential development only. Under the zoning law, a local plan is required for each specific physical development.[18] Within a local plan, each individual parcel of land is prescribed a permissible use.

A developer may apply to change the use of all or part of a parcel of land by applying to the town and country planning division of the local district authority.[19] The request must be accompanied by a report prepared by a professional planner. A change of use must not significantly alter the original intention of the plan or zone, and not cause disruption to the surrounding land uses by way of significantly increasing traffic generation or increasing noise or odour, or increasing the risk of fire or explosion or undermining the image of the area or being a risk to public health, etc.[20] The process of re-zoning can take a significant amount of time, and as such investors must take this into consideration in acquiring properties that must be re-zoned prior to development.

ii Environment

In order to obtain a building permit from the local district authority for large-scale and significantly impacting activities, an environmental assessment registration form, together with a site plan and zoning letter from the town and country planning department of the authority, must be submitted to the Environmental Protection Agency (EPA). Following submission, the EPA will, within 25 days, request that the applicant conduct a detailed environmental impact assessment study (EIA) in order to fully understand the environmental impacts of the proposal and how any negative impacts will be mitigated. A decision on the EIA is made with the assistance of a cross-sectoral technical review committee within 50 days

18 Land Use and Spatial Planning Act 2016 (Act 925), Section 72.

19 Land Use and Spatial Planning Act 2016 (Act 925), Section 93.

20 Ministry of Environment Science and Technology, Town and Country Planning Department Zoning Guidelines and Planning Standards, published in November 2011.

of submission. Large-scale and significantly impacting activities listed in the Environmental Assessment Regulations 1999 (LI 1652) include housing; resort and recreational development; and power generation and transmission.[21]

A building permit will not be issued for the development of environmentally contaminated land until the levels of toxicity on it are remediated to levels acceptable to the EPA. The party responsible for the remedying of contaminated land is subject to agreement between the vendor and purchaser. The EPA shall issue penalties for operating large-scale activities as above-mentioned, without the requisite permits.

iii Tax

Stamp duty is payable on all documents conveying interests in land. The duty assessable is a function of the value of the property conveyed. For properties valued under 10,000 cedis, the duty is assessed at 0.25 per cent of the value of property conveyed.[22] For properties valued between 10,000 cedis and 50,000 cedis, duty is assessed at 0.5 per cent of the value, and for all other properties the duty is assessed at 1 per cent of the value. Any instrument by which property is conveyed must be presented for stamping within two months of its execution.[23]

All commercial rent and other charges such as common area maintenance charges and utility charges are subject to VAT at a rate of 17.5 per cent. Although the VAT is an end-user tax that may be passed on to the tenant, the landlord is liable for the collection and payment of the tax. The landlord is, however, permitted to offset the aggregate VAT paid on certain good and services acquired by the landlord in providing his or her services (input VAT) against the VAT collected on rent and utility payments from tenants (output VAT), and is only required to pay the excess of the output VAT over the input VAT. The payments are made on a monthly basis, along with the submission of a return.

Withholding tax is also payable on commercial rent received as investment income at a rate of 15 per cent. As such, in the absence of a withholding tax exemption, commercial tenants that are legal persons are required to deduct withholding tax from their rent payments and to provide the landlord with a withholding tax certificate issued by the Ghana Revenue Authority as evidence of payment of the amounts withheld.

iv Finance and security

Large-scale real estate transactions are typically financed using term loans with comprehensive security packages, including a mortgage, a charge over the shares of the project or asset owning company, fixed and floating charges over any other assets of the project company and assignments by way of security of the various project development agreements. Mortgages must be in writing, properly attested before the registrar of the high court, stamped and registered at a number of registries in order to be enforceable.

The mortgage, as well as any other security, will need to be registered at the Collateral Registry[24] within 28 days of creation. Where the mortgagor or chargor of the security is a company incorporated in Ghana, the mortgage and other charges must be registered at the

21 Environmental Assessment Regulations 1999 (LI 1652), Regulation 3, Schedule 2.

22 As at 6 December 2017, US$1 = GHS 4.3977 per Bank of Ghana exchange rates.

23 Stamp Duty Act 2005 (Act 689), Section 12(1).

24 Borrowers and Lenders Act, Section 25.

Registrar Generals' Department within 28 days of the creation of the charge;[25] and last but not least, all mortgages must be registered under PNDCL 152[26] or Act 122,[27] depending on whether the mortgaged property is situated in a registration district.

The registration of a mortgage is mandatory for the presumption of validity of the mortgage instrument and to give effect to the charge created. The courts have held that, in the absence of registration, a mortgage is ineffective and unenforceable and the possession of the title deeds or part performance by the mortgagee does not create an equitable mortgage.

VI LEASES OF BUSINESS PREMISES

Leases in Ghana must be written and must be signed by the person making the transfer or his or her agent. A description of the property is required in order to give effect to the transfer. In order to be enforceable and to be used in evidence in a court of law in Ghana, the instrument of transfer must be stamped and where the term of the lease is longer than two years and the property is situated in a registration district, the lease must be registered under Act 152.

The terms of commercial tenancies typically range between two and five years, although longer terms are permissible. Rent is typically assessed according to the square area let, and commercial rents currently range between US$20 per square metre per month and US$45 per square meter per month. Owing to the depreciation of the Ghana cedi, many commercial landlords will stipulate the rent in US dollars (in spite of the fact that this is not permitted under the Foreign Exchange Act 2006), but rents are payable in the Ghana cedi equivalent. Rents are typically payable quarterly or semi-annually in advance, but it is not unusual for landlords to require a year or more in advance.

Tenants are typically required to pay common area maintenance charges of between US$3.50 and US$5 per square metre per month in addition to rent. These fees are also payable quarterly or semi-annually in advance. Tenants are also usually responsible for their phone and electricity charges. Charges for the consumption of water are usually included in the common area maintenance fees. Where a landlord intends to increase rents, the Rent Act (Act 220) 1963 requires that the tenant be notified in writing prior to the increase of the new rates of the rent and the date from which the new rates will be applicable. In practice, tenancy agreements typically include rent escalation provisions of 5–10 per cent on an annual or biennial basis.

Lessees are usually permitted to sublet, undersign or assign the lease with lessor's written consent prior to the transfer. Termination and eviction for breach are only permissible by agreement or by court order.

VII DEVELOPMENTS IN PRACTICE

One of the most relevant developments in real estate law in Ghana is the introduction of the Land Use and Spatial Planning Act[28] (Land Use Planning Act) that applies to entities including large and small-scale property developers. The Land Use Planning Act introduces the requirement for zoning. The vendor or lessor of land must ensure and demonstrate that

25 Companies Act 1963 (Act 179), Section 107(1).
26 PNDCL 152, Section 72.
27 Act 122, Section 24.
28 Land Use and Spatial Planning Act 2016 (Act 925).

the land is zoned for the specific purpose which the lessee or buyer requires the land[29] by attaching evidence of the approved land use to the instrument of transfer. The Land Use Planning Act also introduces the drawing up of a local plan by estate developers according to approved standards. Developers seeking to set up real estate development in phases must prepare a local plan for the area concerned.[30] A local plan should be drawn up and adopted before the approval of a development scheme in respect of the layout of land for more than 20 individual plots, each of which is not less than 110 square metres and for major redevelopment schemes in urban areas.[31]

Another development in Ghana's real estate law is an administrative policy introduced by the Lands Commission requiring site plans to be marked by bar codes to allow ease of identification. The policy was introduced pursuant to the Survey (Supervision and Approval of Plans) Regulations[32] that require licensed surveyors to carry out surveys, and for the Director of Surveys to approve of surveys. It is a pilot initiative that the Commission may roll out to other parts of the country, depending on its success. The intention is to digitise and upload accurate information on the land surface of Ghana as well as the relevant information on the parties possessing interests in the land. It is also to simplify the registration process and streamline the recording of such information. This policy began in 2016 in Accra, and may be extended to the Tema district by 2018.

VIII OUTLOOK AND CONCLUSIONS

The outlook for the real estate sector looks positive owing to projections for improved national economic performance and specific government initiatives aimed at stimulating the development of the low income housing sector and the development of real estate investment funds and other sources of financing for real estate investments. There are also a number of legislative reforms that are under consideration that would improve the regulatory landscape for real estate investors.

In 2018, the government intends to initiate reforms that encourage pension and insurance firms to invest in private equity and real estate insurance funds (REIFs). The government has plans to exempt collective investment schemes and REIFs from taxes in order to attract funds from pension funds, sovereign wealth funds, endowments, insurance companies, mutual funds and high net-worth individuals, both local and international, to finance real estate transactions.

Ghana also has a Real Estate Authority Bill that, if passed into law, could change the critical aspects of the real estate industry in Ghana. The purpose of the Bill is to regulate real estate transactions including the sale, rental and leasing of real estate as well as overseeing and licensing real estate agents. It establishes the Real Estate Authority as its governing body. Once passed into law, it will require real estate agents to pass a qualifying exam before being licensed to practice. This means those seeking to use the service of an agent must ensure they are dealing with a duly licensed agent, and that anyone seeking to operate in the real estate industry must pass through the outlined procedure to become a licensed agent.

29 Land Use and Spatial Planning Act 2016 (Act 927), Section 96.
30 Land Use and Spatial Planning Act 2016 (Act 927), Section 73.
31 Land Use and Spatial Planning Act 2016 (Act 927), Section 74.
32 LI 1444.

The Bill will also initiate the issuance of real estate transfer certificates and will provide standard forms for certain types of transactions such as purchase agreement and sales agreement forms. The real estate transfer certificate to be issued by the authority will signify the completion of a real estate transaction. Interestingly, only licensed agents would be able to apply for the real estate transfer certificate that must be presented by the proprietor of land for the registration of his or her interest in the property.

Chapter 15

GREECE

Nikos A Vouhiounis and Christina C Zakopoulou[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

The general principles of Greek property law can be found in Chapter 3 of the Greek Civil Code (CC), Articles 947–1345. Specific matters relating to real property are dealt with in other parts of the CC, the Greek Code of Civil Procedure and other pieces of legislation.

Real property rights include the right to ownership (Article 999 CC), which can be further distinguished into full ownership, bare ownership and usufruct; easement rights (Article 1118 CC); and the right to mortgage (Article 1257 CC), as follows:

a full ownership constitutes a universal real right. It may be absolute (100 per cent ownership) or joint (ab indiviso ownership);

b bare ownership is a limited real right and constitutes part of full ownership; the bare owner lacks the advantages of usufruct, which means he or she cannot use or exploit the property until the death or resignation of the usufructuary, in which case usufruct is unified with bare ownership and the bare owner becomes the full owner of the property;

c usufruct is a personal servitude and constitutes also part of full ownership. The usufructuary may use and exploit the property that belongs to the bare owner. However, the usufructuary must preserve the property intact (i.e., he or she cannot alter the property's shape, form, size), although he or she is not responsible for any deterioration or wear due to natural causes. Usufruct is established by means of a notarial deed;

d easement rights constitute a limited real right (e.g., right of way) that is exercised by the owner of a property (dominant estate) and burdens a third-party property (subservient estate);

e the right to mortgage consists of a limited real right granted to a beneficiary, to secure a claim of the beneficiary against the owner of the property. In cases of enforcement of this right, the beneficiary is able to satisfy his or her claim from the proceeds of the auction of the burdened property. A mortgage is distinct from a pre-notation of mortgage, which can be turned into a mortgage subject to the suspensive condition of final adjudication of the secured claim to the creditor and the switch of the pre-notation into a mortgage.

Finally, in the context of Law 3986/2011 on Urgent Measures for the Implementation of the Mid-Term Fiscal Strategy Framework 2012–2015, the concept of 'surface right' was reintroduced into Greek Law, after almost a century. The right refers only to real property

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assets owned by the Greek state or public sector legal entities, and it is granted for an initial period of up to 99 years by way of a notarial deed, subject to payment of an agreed amount. The beneficiary of the surface right enjoys all rights of the owner of the asset and has the right to build, develop, exploit and manage the asset. Furthermore, the beneficiary of the surface right may grant security over the asset to third parties (e.g., in the context of financing). The beneficiary of the surface right is also under the obligation to maintain and protect the asset and return it to the owner at the end of the agreed surface right term.

ii Ways of acquiring ownership of real property in Greece

Ways of acquiring real property under Greek law include:

a acquisition of real estate by notarial deed (asset deal) (i.e., written notarial contract entered into between the owner and the buyer, which is executed before a notary public). Upon execution, the purchase deed should be forthwith registered with the competent land registry and cadastral office so that the new owner acquires valid title over the property. According to Articles 1033 and 1198 CC, the acquisition of ownership is not effected until registration of the notarial deed with the land registry and cadastral office is completed;

b acquisition of the shares of a special purpose vehicle (SPV) that holds ownership rights over real property (share deal) (i.e., private agreement for the sale and purchase of shares entered into between the seller and the buyer). No registration or filing with any public authority is required since owner of the real property remains the SPV, the shares of which are transferred;

c acquisition by virtue of succession, whether testate or intestate;

d acquisition by donation or by parental grant;

e acquisition by auction (i.e., by act of compulsory enforcement, brought against the debtor's property, where the ownership of property is finally acquired by the highest bidder);

f acquisition by the person who has been in possession of the property for 20 years and exercises proprietary rights thereon (extraordinary usucaption); and

g acquisition by the person who, acting in good faith, has been in possession, with legal title, of a property for a decade (ordinary usucaption).

In the context of either an asset deal or a share deal, the seller provides representations and warranties to the buyer with respect to the non-existence of any actual or legal defects over the asset. In particular, such representations and warranties confirm, *inter alia*, the full and undisputable title over the asset, the absence of any liens or encumbrances and of any third-party claims, that there are no town-planning or environmental defects, that all necessary permits and licences have been duly issued and are still in force, and that there are no forestry or archaeological issues, etc. Additional representations and warranties may be given depending on the type of the asset and its particulars (e.g., location and permitted use).

iii System of registration

There are currently two different registration systems for real property in Greece (i.e., the land registry system and the cadastral system), which in some areas run in parallel.

A large number of land registries exist all over Greece, each covering a specific area. They actually cover every real property asset in the country and, in this respect, there is a competent land registry for every asset. The registration with the land registries is made by reference to the name of the owner. In some areas, two land registries may be competent, in parallel, for the same property. This is the case where a new land registry is established to cover a specific part of an area that was previously within the competence of a pre-existing land registry. In these cases, earlier ownership titles are registered with the pre-existing land registry, while titles of ownership acquired after the establishment of the new land registry must be registered with the latter.

As regards the procedure for the creation of the National Cadastre, this now covers a substantial part of the country and is expected to be completed in the next two to three years. Under the cadastral system, registration is made by reference to the details of the real property asset (and not of the owner, as is the case with the land registry), whereby each property is identified by a unique ID number.

In areas where both a land registry and a cadastral office operate, registration should take place in both. Both land registries and cadastres issue certificates regarding the registration of the ownership titles of a property, the existence of any encumbrances, third-party claims, etc.; however, such certificates are not guaranteed by the state and are not always 100 per cent accurate (at least in the case of land registries). In the absence of an electronic database for real estate assets, and especially with regard to data kept by the land registries, it is advisable to carry out an on-site title search, particularly with the competent land registry, prior to acquiring real property. Such a search aims to confirm the undisrupted succession of ownership of the asset for at least 20 years and also that no encumbrances, third-party claims, easement rights, expropriations, etc, exist.

Overall, note should be taken of the importance of registration of the notarial deed, pursuant to which the transfer of a real estate asset is effected, as under Greek law, Articles 1033 and 1198 CC, the transfer of ownership is completed only upon registration of the notarial deed.

iv Choice of law

According to the rules of international private law, as incorporated in the CC (Article 4 et seq. CC), the principle of lex rei sitae applies to real property assets located in Greece (Article 27 CC). The same rule also applies with regard to the type of contract that is necessary for the valid creation, modification, conveyance or amendment of real rights over real property assets located in Greece (Article 12 CC).

II OVERVIEW OF REAL ESTATE ACTIVITY

During the past two years, owing to the political stability in the country and the reforms of the Greek government, there has been increasing interest on the Greek real estate market by foreign investors (in most cases private equity funds). The main sectors attracting such interest are the touristic and the residential sectors.

In view of the considerable increase in the number of tourists visiting Greece, foreign investors have been closely monitoring the touristic industry for investment opportunities. It should be noted that the heavily indebted Greek touristic industry is quite attractive to foreign investors. From the other side, Greek banks are keen to resolve the nonperforming loan (NPL) issue and regularise their portfolios. As a result, Greek banks, after coming into agreement with foreign investors, seek to enforce their step-in rights under the financing granted to hotel companies, allowing the investors to participate in the share capital of hotel companies and in most cases take over, through share capital injection. Following completion of the investment, either the debt is fully repaid or a re-financing is agreed to the interests of both parties.

As regards the residential market, the main interest of investors appears to be in the acquisition and refurbishment of old multistorey apartment buildings, in the centre of Athens and Thessaloniki, to be used either as Airbnb or to be leased to students or expatriate corporate officials and the like.

In addition, as a result of the 'golden' visa programme introduced by the Greek state, there is a huge interest on medium-value residential properties, especially from Middle-East and Chinese nationals. It should be noted that the Greek golden visa programme is considered to be one of the most attractive among other EU Member States' similar programmes, while it fully complies with the immigration principles of the EU.

Following implementation of the new legislation on NPLs and the commencement of enforcement and real estate auction proceedings from Greek banks, it is anticipated that a large number of real estate assets shall be available, at discounted prices, attracting further interest from investors.

III FOREIGN INVESTMENT

i Development Law 4399/2016

The much anticipated new Development Law published in June 2016 aims to promote the balanced development with respect to natural and environmental resources, to establish and facilitate the use of new technologies, to improve the competitiveness in several business sectors and also to upgrade the services provided. Also, it aims to attract direct foreign investments and to ensure the positioning of Greece in the international division of labour.

In order to achieve this the new Development Law contains provisions with regard to the granting of aid, the acceleration of authorisation and investment evaluation and control processes, the development of the country's human resources, the granting of incentives for international investors and the development of networks and synergies.

Also, special rules have been adopted with regard to the implementation and completion of investment projects, especially in the context of encouraging mergers and developing sections and interventions to enhance healthy and targeted entrepreneurship with a special emphasis on small and medium entrepreneurship.

ii Fast Track Law 3894/2010

Law 3894/2010 on Acceleration and Transparency of Implementation of Strategic Investments (the Law) was enacted with a view to addressing foreign investors' concerns that Greek state bureaucracy in respect of licensing, planning, zoning, etc, delays the implementation and operation of any kind of investments, including real estate.

The Law applies to strategic investments, defined therein as productive investments implemented by the private or public sector and generating quantitative and qualitative results of major significance for the entire Greek economy. Such investments may relate to various sectors (i.e., industry, energy, tourism, transport, communications, the health sector, waste management and cutting-edge technology). For an investment to benefit from the Law, various factors are taken into consideration, such as the total investment cost or, irrespective of cost, the creation of at least 150 employment positions, the investment's viability, the investor's creditworthiness, the increase in export activity and development on a local level.

Investments captured by the Law enjoy a number of benefits including: (1) special deviations from the restrictions deriving from applicable legislation, (2) strict time frames for licensing, approvals, etc., and (3) tax benefits.

In this respect, a state-owned entity has been established, namely Enterprise Greece Invest and Trade SA, operating as a one-stop shop for the licensing and authorisation of investments captured by the Law. This entity also provides information to interested investors on the institutional, legal, tax and financial framework governing investments in Greece. The entity's site – www.enterprisegreece.gov.gr – includes comprehensive information for potential investors in various languages.

iii Immigration and Social Integration Code Law 4251/2014

This law gives the possibility of granting residence permits to third-country nationals and members of their families who purchase real estate property in Greece, the value of which exceeds €250,000.

More specifically, by decision of the Secretary General of the Decentralized Administration, residence permit for five years, subject to renewal, is granted to a third-country national who:

a has legally entered the country with any type of visa or legally resides in the country;

b has full ownership, possession and peaceful enjoyment of real estate property in Greece worth €250,000;

c has full ownership, possession and peaceful enjoyment of real estate property in Greece via a legal entity, whose shares are fully owned by him or her;

d has concluded an agreement for at least 10 years' lease of hotel accommodation or furnished tourist residences in tourist accommodation complexes, pursuant to Article 8 paragraph 2 of Law 4002/2011 (Government Gazette 1, No. 180); and

e has concluded a time-sharing agreement pursuant to the provisions of Law 1652/1986 'Time sharing agreement and related issues' (Government Gazette 1, No. 167), as in force.

The minimum value of the real estate property, as well as the contractual consideration of hotel accommodation or tourist residence leases, must have been paid in full upon the signing of the contract. The third-country national may be accompanied by the members of his or her family to whom, at their request, an individual residence permit is issued that expires together with the residence permit of the sponsor.

The permit may be renewed for an equal duration each time, provided that the real estate property remains in the ownership and possession of the third-country national and all other requirements, provided by law, are fulfilled. Periods of absence from the country shall not disrupt the renewal of the residence permit.

IV STRUCTURING THE INVESTMENT

i Main types of investment structure

There are two main types of investment structure to be considered in the case of investment in Greek real property by EU or overseas investors: the direct acquisition of the asset (asset deal structure), under which the non-Greek individual or legal entity proceeds directly to the purchase and acquisition of the real property asset; or the indirect acquisition of the asset (share deal structure), under which the non-Greek individual or legal entity proceeds indirectly to the purchase and acquisition of the real property asset through the establishment of a legal entity in Greece.

The main issues that impact on the decision for the deal structure are:

a the applicable special property tax: the investor, under any type of investment structure (asset or share deal), should take into consideration the provisions on the annual special property tax (see Section V, below) and the conditions for exemption therefrom;

b income taxation and exit strategy: investors usually opt for a share deal; it has proven expedient for the Greek legal entity acquiring the asset not to be directly held by the investor. A holding company or even a series of non-Greek entities may be set up by the investor to deal with, *inter alia*, the investment, financing and holding of different sets of assets as well to implement the investor's overall strategy. Investing in real estate in Greece through a legal entity or entities established in another EU jurisdiction may support a zero per cent dividend withholding in Greece (subject to the conditions set by law) and potentially facilitate future changes in the shareholding structure or the exit from the investment. In this respect, the applicable law finally chosen should, either through local legislation or by virtue of bilateral agreements executed with the country of the investor's establishment, provide for better terms than those included in the relevant double taxation treaty executed between Greece and the country of the investor's establishment; and

c financing of the investment: Greek income tax law, as in force to date, provides for specific rules on interest tax deductibility and thin capitalisation that should be taken into consideration. Withholding tax obligations on interest paid to a non-Greek lender should also be examined according to domestic, EU and double taxation treaty provisions.

ii Real estate investment companies (REICs)

REICs are special purpose companies that invest in real estate and manage income deriving from real property assets. REICs are mainly governed by the provisions of Law 2778/1999 on Real Estate Mutual Funds – Real Estate Investment Companies and other provisions, as in force. Their minimum share capital amounts to €25 million, an amount that can be revised by the Hellenic Capital Market Commission, and it is required that they distribute at least 50 per cent of their profits to their shareholders. Also, it is mandatory that a REIC is listed on the Athens Stock Exchange two years after its incorporation and its shares need to be registered.

Any change to the articles of association of a REIC or any share capital increase must be approved by the Hellenic Capital Market Commission. REICs benefit from a special tax framework, including exemptions from property transfer tax on acquisition, capital gains tax on the sale of property, tax on dividends, etc.

Furthermore, REICs' assets are valued by an external auditor every six months, with an asset valuation required prior to the purchase or sale of any property. Any property acquired by a REIC must be held for a period of at least one year before its resale is permitted and at least 80 per cent of a REIC's capital must be invested in real property assets. The remaining 20 per cent can be invested either in stocks, deposits or other market instruments according to Article 22 of Law 2778/1999, as in force. Lastly, a REIC is allowed to borrow an amount of up to 75 per cent of its assets' value from a credit institution.

V REAL ESTATE OWNERSHIP

i Planning

Major urban planning reforms in the real estate legislation have been enacted lately in an effort to attract investments. The main change was introduced by Law 4269/2014 on Urban and Town Plan Reform, according to which spatial planning has been divided into three main levels – national, regional and local – and into two different main types – strategic and regulatory – while various authorities have been entrusted with the implementation of this scheme. Moreover, Law 4269/2014 aims to liberalise land-use restrictions and impose general rules that will make it easier to integrate commercial, recreational and other facilities within residential areas, contrary to the provisions of the previous over-restrictive and outdated legislation. Again, specific restrictions may apply depending on the circumstances (urban plan, type of building, proximity of archaeological sites, etc.). In general, a property's building coefficient depends on its location and whether it is located within or outside the town plan (which largely coincides with the classification of a property as urban or rural). In the latter case, the landowner must own a plot of at least 4,000 square metres to develop the property. In the former case (i.e., in most urban areas), the building coefficient, is set from 0.8 to 1.2, except for sites that are considered as touristic, where the coefficient is 0.6. Other restrictions on real estate development may derive from land or urban plans, environmental protection issues, archaeological restrictions or sector-specific activities.

ii Environment

The Greek Constitution provides that the protection of the natural and cultural environment is a duty of the state (Article 24, paragraph 1). For this purpose, special preventive or repressive measures in the context of the 'principle of sustainable development' need to be adopted. In addition, relevant EU directives on environmental protection have been incorporated into Greek law. In particular, Law 4014/2011 on Environmental Licensing of Projects and Activities provides for environmental licences of a special status for specific projects and activities, including, *inter alia*, any construction and operation that may have an impact on the environment.

In cases of breach of the relevant legislation, fines are imposed by the competent administrative authorities, while criminal charges may also be brought against the offender, be it a natural person or a legal entity. In the case of legal entities, the criminal charges are brought against the directors and officers of the legal entity concerned.

It is important to note that, as from 2011, the issuance of Energy Performance Certificates for residential buildings (primary or secondary), commercial stores, offices, hotels, warehouses, etc, is required, subject to statutory exceptions (see Laws 3661/2008, 3851/2010 and 3889/2010). The issuance of such certificates is mandatory for all buildings prior to being leased or transferred.

Finally, because of Greece's geographical characteristics, special legislation has been adopted for the protection of the seashore and the beach, in particular Law 2971/2001 on the Seashore and the Beach, as in force following its amendment by Law 4321/2015 on Restarting the Greek Economy, which provides that the seashore and the beach are considered to be public-use areas belonging to the state, with the state being responsible for their protection and management. Unimpeded access of the public thereto must be preserved at all times. However, such access may be restricted by way of a special duty or fair, in the case of organised beach facilities, touristic developments, etc.

Also, it is expressly provided that the construction of buildings and other facilities on the seashore and the beach is not allowed, except for uses related to public interest, environmental and cultural purposes, and for recreational activities.

iii Tax

Income tax on Greek legal entities

Greek legal entities keeping double-entry accounting books are annually subject to corporate tax at the flat rate of 29 per cent on their taxable income.

According to interpretative guidelines issued recently by the Greek Ministry of Finance, non-Greek entities holding real estate in Greece should keep double-entry accounting books, unless subject to specific exemptions.

The calculation of taxable income is made by reference to the income gained from all sources and the expenses incurred for its acquisition. Income from real estate is treated as business income. Expenses incurred for the acquisition of the income above are tax deductible, subject to specific restrictions.

The distribution of dividends is subject to 15 per cent withholding income tax. Specific rules provide for certain exemptions to dividend withholding.

Income tax on individuals

Income from real estate (e.g., rental income, income from own use and from the concession of use) earned by individuals is subject to income tax according to an income or tax rates scale, which provides that income up to €12,000 is subject to tax at the rate of 15 per cent, income between €12,001 and €35,000 is subject to tax at the rate of 35 per cent, while income exceeding €35,000 is subject to tax at the rate of 45 per cent. The law provides for the tax deductibility of specific expenses incurred.

Real estate transfer tax

Real estate transfer tax, at 3 per cent, is due on the transfer of real estate property situated in Greece. The tax due is calculated on the higher of either the sales price stated in the contract or the deemed value of the property, calculated according to the formula provided by the Ministry of Finance. Municipal levies, at the rate of 3 per cent, are calculated on the amount of the real estate transfer tax due. The law provides that the above 3 per cent tax rate may be reduced or transfer tax may not even be due upon fulfilment of specific conditions (e.g., division of real estate property held ab indiviso or acquisition of family housing).

VAT at 24 per cent (standard rate), instead of 3 per cent transfer tax, is due on the transfer of new buildings, whose building permit is issued or renewed (and construction works have not started) after 1 January 2006. Any building that has not been used (i.e., has not been leased or used by the enterprise for its own services, etc.) is considered new. If the complete file for construction works was submitted to the City Plan Agency and a preliminary agreement and a contractor's agreement were signed before 25 November 2005, VAT exemption may be granted, following a specific request to the tax authorities.

Capital gains tax

The Income Tax Law (Law 4172/2013) provides that, at the year end, legal entities are subject to tax at the rate of 29 per cent on capital gain deriving from the sale of real property assets and on all other income gained by the entity (for entities keeping double-entry books).

Individuals (who do not act as entrepreneurs) deriving capital gain from the sale of real property assets are exempted from taxation until 31 December 2016. The application of the provisions of Article 41 of the Income Tax Law, ruling on the taxation of capital gains at 15 per cent, is postponed until 31 December 2018.

Taxes on holding real estate property rights in Greece

Unified real estate tax (URET)

URET is imposed as of 2014 and for each subsequent year on any real property asset located in Greece and owned by natural persons or legal entities on 1 January of each year. Any person or entity holding a right over real property is subject to this tax.

URET is equal to the amount of the main tax calculated on each property (buildings and plots of land) and the additional tax calculated on the total value of the rights existing over such real property. The main tax for the rights on buildings ranges between €2.5 and €16.25 per square metre. The main tax for the rights on plots of land ranges between €0.003 and €9 per square metre. The additional tax is imposed on the total value of rights over a legal person's real property, and ranges between 0.5 per cent and 2.5 per cent. For individuals, the range is set between 0.1 per cent and 1 per cent and applies to real estate property exceeding the value of €300,000.

Special property tax

The special property tax is imposed on entities that have full ownership, bare ownership or usufruct rights on real property assets located in Greece. It is calculated at 15 per cent of the deemed value of the property. It is imposed on any property located in Greece for relevant ownership rights owned on 1 January of each year, regardless of any changes in these rights during that year. The law provides for an exhaustive list of exemptions from the above rule.

Local real estate duty

Local real estate duty is imposed on every real property asset that is included in the city plan and on buildings that are not included in the city plan. The duty ranges between 0.025 per cent and 0.035 per cent of the deemed value of the property and is levied by the Public Power Corporation or any alternative supplier of power.

iv Finance and security

Financing in real estate projects in Greece usually takes the form of a loan granted to the purchaser by a financial institution. As a matter of standard Greek banking practice, real estate financing requires security over real property, insurance proceeds, bank accounts and rentals and other receivables relating to the property, whether of first ranking or of acceptable subsequent ranking.

As far as the real property itself is concerned, the lenders will need a due diligence report on ownership without reservations or, alternatively, identification of any existing encumbrances or third-party claims and any other matters that could create illegality or unenforceability issues in connection with the property and its further exploitation. The legal due diligence report is normally supplemented by a technical due diligence report, on the basis of which planning or environmental issues, as well as any building or operating licences that may need to be obtained or could not be obtained, can be identified. If the due diligence report is subject to reservations, the lenders will expect the report to clearly identify any issues relating to the property in a manner that can assist them in assessing the risks and deciding whether these risks are acceptable and on what terms.

As an alternative, financing may be granted to a potential real estate investor in the form of a financial leasing agreement (Law 1665/1986 on Financial Leasing). Pursuant to the agreement, the leasing company acquires the real property asset from the vendor and leases the same to the investor, who is under the obligation to pay leasing rentals for an agreed period, while acquiring ownership over the asset upon full repayment of the leasing amount.

VI LEASES OF BUSINESS PREMISES

Commercial lease agreements are governed by Presidential Decree 34/1995 on Codification of Legislative Provisions Regulating Commercial Lease Agreements (the Lease Law), as amended and in force. In respect of all matters not explicitly governed by the Lease Law, the relevant provisions of the CC apply.

i Duration and early termination

As a general rule, commercial leases concluded prior to 28 February 2014 (when the provisions on leases were amended by Law 4242/2014) are valid for a 12-year term (even if concluded for a shorter period) or any agreed longer term of definite duration. Leases concluded after 28 February 2014 are valid for a three-year term, even if concluded for a shorter period or if they are of an indefinite duration.

The right of the lessee to terminate the lease agreement following the lapse of one year, by giving three months' prior written notice and paying one month's rent as compensation, is applicable as regards lease agreements concluded prior to the amendment introduced by Law 4242/2014.

As regards 'new' leases (i.e., those concluded after 28 February 2014), after taking into consideration the continuation of the Greek financial crisis, Greek courts recently ruled that in the case of early termination there is no obligation for the lessee to pay the remaining rent for the minimum three-year lease term.

ii Rent and rent adjustments

Within the context of the lease agreement, the parties agree on a monthly rent and its readjustment. In view of the severe economic crisis in Greece during the past five years, as regards new lease agreements, the parties usually agree that there will be no increase for the first two to three years of the lease term. After that period, there is usually an agreement on an annual increase of the rent by reference to the annual consumer price index of the preceding lease year, plus 1 per cent or 2 per cent. Also, in the case of lease agreements that were concluded prior to the onset of the economic crisis and that include provisions on high rents and considerable annual increases, lessees have sought to amend such agreements either in agreement with the lessor or by pursuing a judicial decision for the decrease of the rent. Recent jurisprudence is favourable to lessees seeking rent reduction.

In any case, a lessee can seek before the court, under Articles 288 and 388 CC, the adjustment of the rent or the termination of the lease, subject to evidence that unforeseeable circumstances have occurred as a result of which the performance of the financial obligations under the lease agreement has become excessively onerous as compared with the obligations borne by the other party in consideration for such performance and in view of the current financial situation in Greece.

Finally, a stamp duty of 3.6 per cent or VAT is imposed on the lease payment, depending on several factors.

VII DEVELOPMENTS IN PRACTICE

i ESHADA

To facilitate investors, Law 3986/2011 provides for general town planning rules and sets out the general uses for which public properties may be developed, which include: (1) tourism and leisure; (2) business parks, theme parks, shopping centres or malls; (3) logistic centres and warehouses; and (4) holiday or tourist villages.

To this effect, special plans for the development of any public asset (ESHADA) are prepared and approved (Article 12, Paragraph 1). The approval is effected by means of a presidential decree and includes: (1) the classification of the asset under one of the general categories of use described above; (2) the particular uses that are allowed; (3) the special building terms and conditions; and (4) the special protection zones that apply to the asset, if any.

Any master plans, general urban plans or urban control zones specific to the area may be amended through this presidential decree. The decree may also amend terms of approved street plans and town plans or urban planning studies, and may set special terms for the use and the building conditions of assets located within an urban plan, even by deviation from the existing town planning terms and conditions. Recently, similar provisions were introduced for public assets located outside urban plans.

Law 3986/2011 further includes provisions that aim at accelerating the issuance of necessary building permits (Article 15). Finally, special provisions aim to grant investment owners a direct concession of the use of the seashore and the beach, in return for the payment of consideration, for a period of up to 50 years, which may be extended for another 49 years (Article 14).

ii Law 4277/2014 – New Urban Master Plan of Athens–Attica

The latest update of the Athens Urban Master Plan was enacted by Law 4277/2014 on New Urban Master Plan of Athens–Attica and other provisions, which was issued following extensive public consultation with all interested parties, including the competent regional, governmental and judicial authorities.

The implementation of the New Urban Master Plan has three targets: the socioeconomic reconstruction of the greater area of Athens; its spatial reorganisation; and the protection of the environment.

The main goals of the reform are, among others, to promote Athens as the principal Mediterranean capital and as a leading business centre, to strengthen the role of Athens as the gateway for tourists visiting Greece and to increase its citizens' standard of living. The measures intended to achieve these targets include investments in expanding the transportation network, the redevelopment of the coastal front, the exploitation of Olympic venues and the development and growth of new touristic products (medical, conference and cultural tourism, etc.) as well as dividing Attica into four separate regions.

Moreover, pursuant to Article 33, the semi-autonomous authority responsible for the implementation of the New Urban Master Plan (i.e., the Organisation for the Planning and Environmental Protection of Athens) has been abolished and its competence has been transferred to the Ministry of Environment and Energy, thus strengthening the central government's role in the implementation of the Athens master plan.

Lastly, the details of the new Master Plan are to be specified in the context of presidential decrees and joint ministerial decisions to be issued in the period to come, whereas its implementation is to be monitored by a new authority to be established pursuant to Article 37 of Law 4277/2014.

VIII OUTLOOK AND CONCLUSIONS

A number of critical factors have encouraged investors to start monitoring the Greek real estate market during the past two years, and to proceed with serious investments, the main ones being the continuous signs of recovery of the Greek economy, the booming touristic industry and the discounted prices – though not extreme – even in prime real estate assets.

Should the Greek government continue the reforms and take measures in order to strengthen the economy, its competiveness and transparency, and also to decrease the applicable real estate taxes, the interest in the market from foreign investors shall continue and shall be further increased. Such interest shall be further established if the NPLs issue is finally resolved and the Greek banks are able to return to their normal course of business, including real estate financing.

Also, given the unstable political and social environment in several bordering countries, as well as in countries around the Mediterranean Sea, which are the traditional competitors of Greece in the touristic market, it appears that the industry shall continue to develop and attract new international investors.

Chapter 16

HONG KONG

Dennis Li[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

In Hong Kong, land grants are made on a leasehold basis. The 'ownership' of the leasehold land is granted by way of a government lease or a government grant. The government grant will contain conditions, which, when satisfied, will lead to a government lease being deemed to be issued (the practice is that the government will not issue an actual government lease). The government lease or grant will usually specify the government rent, term duration, building covenants and user restrictions, the breach of any of which entitles the government to re-enter the land and determine the government lease or grant.

For multistorey buildings, government leases are granted for the piece of land on which the building is erected. There is no separate government leases for the ownership of units in that building and all unit owners are 'co-owners'. A deed of mutual covenant governs ownership of each individual unit in a building by notionally dividing the combined land and building into a number of undivided shares and allocating a certain number of these undivided shares to each unit in the building. These undivided shares have attached to them the right to exclusive use and possession, and the purchase of a unit in a building is effected by way of an assignment of all the rights attached to those undivided shares for the remainder of the term of the government lease.

Following the change of sovereignty on 1 July 1997, all land in Hong Kong became property of the People's Republic of China, and the responsibility for the management, use and development rests with the government of the Hong Kong Special Administrative Region of the People's Republic of China (Hong Kong). The Basic Law of Hong Kong provides that government leases granted prior to 1 July 1997 will continue to be recognised and protected under the laws of Hong Kong. All government lease terms are either granted or entitled to an extension for another 50 years or until 2047.

ii System of registration

Hong Kong operates on a system of document registration (as opposed to title registration) where instruments affecting real properties are lodged for registration with the Land Registry. The registered particulars and relevant documents are open to public inspection. Registration in the Land Registry confers priority on registered documents and serves as notice of registered instruments to anyone dealing with the particular property.

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However, the document registration system in Hong Kong only determines the priority of registrable interests in real property. Under Section 2(1) of the Land Registration Ordinance, 'deeds, conveyances, and other instruments in writing, and judgments' affecting land are capable of being registered with the Land Registry. Consequently, a registered interest holder may be in competition with an unregistered interest holder of an unregistrable interest in real property. In these circumstances, priority is determined in accordance with common law principles.

All registrable instruments registered within one month after the date of execution will take priority from their execution date. All registrable instruments registered after one month after the date of execution will take priority from the registration date.

Although the register maintained by the Land Registry does not establish title to the property, the Land Registry does act as a record of transactions that can be relied upon in establishing the details of the title to a particular property.

The Land Titles Ordinance was passed by the Legislative Council on 7 July 2004, which provides for the gradual conversion from the existing deeds registration system to a title registration system. However, the Land Titles Ordinance is not yet in force, and it is unclear when preparatory work will be completed to enable the commencement of the Land Titles Ordinance for a title registration system in Hong Kong.

iii Choice of law

A contract may have a clause expressly providing the governing law applicable, which will generally be upheld by the courts, but formalities, including conveyance and securitisation of the property and registration of instruments in the Land Registry, will usually be governed by Hong Kong law.

II OVERVIEW OF REAL ESTATE ACTIVITY

The real estate market in Hong Kong in 2017 has seen an upward tick in prices but a slight decline in the number of transactions. The year started with a mild dip in the first two months that gradually increased to levels comparable to the same period in 2016.[2]

The Hong Kong government announced that the *ad valorem* stamp duty for the sale or transfer of immovable residential property in Hong Kong would be increased to a flat rate of 15 per cent (effective from 5 November 2016). This measure forms part of the demand-side management effort to address the concern of an overheated residential property market and to reduce the risk of a 'housing bubble'. The flat rate of *ad valorem* stamp duty is applicable to all acquisitions of residential property by individuals and companies, with exemptions as provided under the existing *ad valorem* stamp duty regime (see Section V.iii, below). However, this increase in stamp duty has not impacted the property market in respect of transaction volume or property value. This new measure will not affect the stamp duty rates applicable to non-residential properties.[3]

2 The Land Registry, 'Current Monthly Statistics (Month: October 2017)' (2 November 2017): www.landreg.gov.hk/en/monthly/monthly.htm.

3 The government of the Hong Kong Special Administrative Region, 'Press Release: New round of demand-side management measures to address overheated residential property market' (4 November 2016): www.info.gov.hk/gia/general/201611/04/P2016110400768.htm.

The special stamp duty (See Section V.iii, below) has also been effective in combating speculative purchasing. Transactions involving confirmer transactions or resales within 36 months after entering into a contract for sale have significantly decreased since 2010, prior to the introduction of the special stamp duty.

In the 2017 Policy Address, the Chief Executive of Hong Kong spoke of plans to redevelop the Wan Chai North area by creating new office spaces, hotels and an expansion of the Hong Kong Convention and Exhibition Centre in Wan Chai. It is expected that such development will increase the supply of office units in Hong Kong, and offer tenants an alternative to Central, the central business district of Hong Kong. In addition, there are hopes that the Wan Chai North project will secure Hong Kong's position in Asia as a hub for conventions and exhibitions.

III FOREIGN INVESTMENT

There are generally no legal restrictions on foreign investors owning, selling, leasing and developing real estate in Hong Kong, but a legal opinion may be required to confirm that the foreign corporate investor has legal power to enter into the transaction, to deal with and to execute the relevant documents involving the Hong Kong property.

In March 2013, the Hong Kong government introduced the 'Hong Kong Property for Hong Kong People' scheme in relation to specific residential property developments. For these developments, a special condition in the government grant restricts alienation of residential units to holders of a Hong Kong permanent identity card and individuals to whom they are closely related. Thus, foreign investments dealings with such developments under the scheme are prohibited unless consent is granted by the Hong Kong government. Since the introduction of this scheme, residential developments restricted to permanent residents of Hong Kong, such as One Kai Tak offering approximately 550 residential units, were introduced. However, many consider the scheme largely unsuccessful owing to the continued high prices of residential units in Hong Kong and the low number of projects developed under the scheme. In 2014, the then Chief Executive C.Y. Leung announced that the scheme was a pilot scheme that would be continued only when the market overheated.

IV STRUCTURING THE INVESTMENT

The structuring of an investment in real estate in Hong Kong will likely be based on tax and accounting considerations of the investor. It is therefore prudent to obtain advice on tax and accounting implications for the investor in both the investor's own jurisdiction and in Hong Kong when investing in Hong Kong property. The availability of financing (and the loan-to-value ratio) may also be a factor when determining the structure of the investment.

i Corporate entity

In Hong Kong, a company is a separate legal entity that can hold real estate assets and mortgage and charge the property it holds. It is not unusual for corporate special purpose vehicles (SPVs) to be set up to hold one or a portfolio of properties. Subject to the administrative requirements under Hong Kong company law, the investor may enjoy advantages of limited liability and tax advantages when realising the value and disposing of the real estate asset through a transfer in ownership of the SPV instead of through assignment of the property.

An investor may also make use of a corporate offshore SPV, depending on regulatory and tax considerations. Popular jurisdictions for setting up offshore SPVs include the British Virgin Islands, the Cayman Islands and Bermuda.

ii Partnership structures

When there is co-ownership and joint management of the real estate asset, a general partnership may be formed if the relation between parties is to carry on a business in common with a view of profit. When deciding whether the parties are partners, the law will look at the substance of the relationship. Partners in a general partnership are liable for each other's debts and liabilities.

The Limited Partnerships Ordinance provides for limited partners who would only be liable up to the amount of their investment. However, limited partners are subject to the restrictions specified in the ordinance, including the limitation that limited partners are not allowed to participate in the active management of the partnership and the real estate assets held, which must be left to the general partners to manage.

iii Real estate investment trusts (REITs)

REITs are collective investment schemes constituted as unit trusts that invest primarily (at least 75 per cent of its gross asset value) in income-producing real estate assets and are listed on the Hong Kong Stock Exchange. The goal of REITs is to provide returns to investors derived from recurrent rental income. The Hong Kong Securities and Futures Commission has issued a 'Code on Real Estate Investment Trusts' (REIT Code) together with other guidance on the authorisation and operation of REITs. The REIT Code prohibits REITs from investing in vacant land other than in specific circumstances or engaging in property development activities unless certain conditions are satisfied and REITs are subject to a maximum borrowing limit of 45 per cent of their gross asset value. REITs have to distribute annually an amount not less than 90 per cent of their audited net income after tax to their investors as dividend.

iv Listed property company

In addition to investing in a REIT, investors may also indirectly invest in Hong Kong real estate by acquiring shares in a Hong Kong listed property company. Many of the major developers and owners of residential, office, retail, industrial and hotel properties in Hong Kong are listed on the Hong Kong Stock Exchange. This method offers a ready and liquid form of investment as well as the regulated governance of a publicly listed company. Conversely, however, a listed company will be subject to regulatory and disclosure requirements and the control which the investor has over the property will be limited.

V REAL ESTATE OWNERSHIP

i Planning

The Town Planning Board is a statutory body established under the Town Planning Ordinance tasked with guiding and controlling the development and use of land and types of buildings suitable for erection, preparing new draft zoning plans, exhibiting draft plans for public comment, considering applications for planning permission, and submitting draft plans for approval by the Chief Executive in Council. Its executive functions are carried out by the Planning Department, which is responsible for creating plans on behalf of the Town Planning Board, providing technical services and enforcing zoning restrictions. The Town Planning Appeal Board hears appeals against the Board's decisions to reject planning applications.

ii Environment

The environment is an issue of significance for town planning and land development, especially as it relates to controlling the pollution generated as a by-product of Hong Kong's economic development and population growth. Governmental supervision is generally by way of proper land use planning, along with appropriate controls at the source through licensing and enforcement of environmental protection ordinances. Environmental planning will be an early consideration when the government scrutinises and considers approving land use plans. The government review will focus on the impact of the development as it relates to air, noise, water and waste aspects.

Development projects that have the potential to cause significant damage to the environment may be classified as Designated Projects under the Environmental Impact Assessment Ordinance and are required to follow the statutory environmental impact assessment process to obtain the requisite environmental permits before construction and operation commence.

iii Tax

Stamp duty on disposition of immovable property

There are three types of stamp duty that may be applicable to the sale of property in Hong Kong. The *ad valorem* stamp duty (AVD) is applicable to all dispositions of immovable property. The government has also introduced a special stamp duty (SSD) and a buyers' stamp duty (BSD) with effect from 20 November 2010 and 27 October 2012 respectively for the sale of residential properties. The SSD and the BSD were introduced with the aim of cooling the overheating residential property market.

The parties legally liable to pay AVD, BSD or SSD are defined under the laws of Hong Kong. However, it is customary for a contract for sale to stipulate that the purchaser will pay the AVD and BSD and the vendor will pay the SSD.

On 4 November 2016, the Hong Kong government announced that the AVD for residential properties will be increased to a flat rate of 15 per cent, subject to existing exemptions. The flat rate is effective from 5 November 2016.

On 11 April 2017, the Hong Kong government tightened up measures on the existing exemptions to the effect that, unless specifically exempted or otherwise provided in the law, acquisition of more than one residential property under a single instrument executed on or after 12 April 2017 will be subject to the proposed new AVD flat rate at 15 per cent.

The AVD chargeable on sale or transfer of non-residential properties in Hong Kong will remain at Scale 1 rates, which is the range between 1.5 per cent and 8.5 per cent, depending on the consideration and valuation of the property.

If an exemption is applicable to the sale or transfer of a residential property, the AVD chargeable will be at the lower Scale 2 rates. Examples of such exemption are when the buyer is a Hong Kong permanent resident and is not a beneficial owner of any other residential property in Hong Kong at the time of acquisition of the residential property or the buyer has divested himself or herself of ownership of all other residential property in Hong Kong within six months. The AVD Scale 2 rates range between HK$100 to 4.25 per cent of the value of the property, depending on the consideration and valuation of the property.

Effective from 27 October 2012, any residential property acquired and resold within certain holding periods, up to 36 months, will be subject to the SSD ranging between 10 per cent to 20 per cent of the value and consideration of the property, depending on the timing of re-sale.

Effective from 27 October 2012, BSD is payable on a contract for sale or a conveyance on sale of any residential property. BSD is charged at 15 per cent on the consideration or the market value of the property (whichever is higher). The BSD is subject to specific exemptions, including the sale of the property to a Hong Kong permanent resident.

Stamp duty on transfer of Hong Kong stock

The acquisition or transfer of shares in a property holding company is not subject to the AVD, SSD or BSD. However, parties will still have to pay stamp duty at the following rates if the transfer directly involves Hong Kong stock:

Document	Rate
Contract note for sale or purchase of Hong Kong stock	0.1% of the amount of the consideration or of its value on every sold note and every bought note
Transfer operating as a voluntary disposition inter vivos	HK$5 + 0.2% of the value of the stock
Transfer of any other kind	HK$5

The parties legally liable to pay stamp duty on the transfer of Hong Kong stock are defined under the laws of Hong Kong. Customarily, the stamp duty is borne by the buyer and the seller in equal shares.

Rates and government rent

Owners of Hong Kong properties will also have to pay rates and government rent on their real estate assets.

Rates are a tax on the occupation of property. They are charged at a percentage of the rateable value being the estimated annual rental value of a property at a designated valuation reference date, assuming that the property was vacant and to be let out. The rates percentage charge is determined by Hong Kong's legislature, the Legislative Council. For the 2016–2017 financial year, the rates percentage charge is 5 per cent.

The basis of the government rent is from the government lease or grant that provides that rent is payable to the government. The government rent is calculated at 3 per cent of the rateable value of the property situated on the land leased and is adjusted with any subsequent changes in rateable value.

Property tax (levied on rental income)

Property tax is levied on property owners on the rental income derived from Hong Kong property. The tax is assessed on the net assessable value of the rental income. The current property tax rate is 15 per cent.

iv Finance and security

The financing of a real estate asset acquisition will usually involve the lender taking security over the property by way of a mortgage or a charge. The distinction between a mortgage and a charge is historical whereby the mortgagee has legal and equitable interest in the land subject to the mortgagor's right of redemption as compared to charge having certain rights, such as the right to sell, but legal and equitable interest still belongs to the chargor. Since 1984, a legal mortgage can only be created by way of a legal charge and the Conveyancing and Property Ordinance grants the holder of a mortgage by legal charge the same rights as a historical mortgagee.[4] Other securities that are common include an assignment of sale proceeds, assignment of rental income and assignment of insurance proceeds. The security documents that effect property will constitute a registrable encumbrance on the property and should be registered with the Land Registry in order to establish the chargee's priority interest.

VI LEASES OF BUSINESS PREMISES

The parties to a commercial lease are generally free to agree to the terms and there is no specified form. With relatively few restrictions on lease agreements with all rules on security of tenure abolished, the law in Hong Kong is generally viewed as being more favourable to the landlord.

i Term

Subject to the remaining term of the government lease or grant, there is no limit on the term of the lease. In practice, the actual length of the term depends on the negotiations between landlord and tenant, taking into account a variety of factors including location, price, use, their respective bargaining power and market conditions. Generally, the lease term for a residential property may be negotiated in ranges between one and three years, whereas lease terms for a commercial property range between two and six years and may be extended with option terms open to negotiation between the commercial lessee or lessor.

ii Registration

A lease or tenancy agreement for a term exceeding three years must be executed as a deed in order to create a legal estate in land. Furthermore, all leases, save for *bona fide* leases at market rent for any term not exceeding three years that are exempted,[5] are required to be registered with the Land Registry in order to establish notice (against a *bona fide* purchaser) and the lessee's priority interest in the property. An option to renew should be registered at the Land Registry even if the original term of the agreement does not exceed three years.[6]

4 Conveyancing and Property Ordinance (Cap. 219) Section 44.

5 It is also possible, but not required for priority, to register *bona fide* leases at market rent for any term not exceeding three years. In practice, it is not uncommon to see leases for less than three years being registered at the Land Registry.

6 *Markfaith Investment Ltd v. Chiap Hua Flashlights Ltd* [1991] 2 AC 43.

iii Rent review

Rent is usually fixed during the fixed term of the lease. Any provision or mechanism for rent adjustment is negotiable between the lessee and the lessor, and would usually be agreed before entering into the binding agreement. A typical provision for rent review in the lease is for the rent to be determined in accordance with prevailing market rent. Generally, an option to renew or extend the term of the lease usually triggers rent review in accordance with prevailing market rent.

iv Lessee's right to sell and change of control

The general practice is for leases to contain an anti-alienation provision prohibiting the lessee from transferring, assigning or subletting the lease or possession of the premises to others whether directly or indirectly. Although this may be subject to negotiation between the parties, it is quite unlikely that the lessor would concede such prohibition or control.

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

A lease or tenancy agreement is a contract and constitutes an interest in land.

Under privity of contract principles, the original contracting parties to the agreement remain liable for the performance of the covenants, terms and conditions that are binding on them. Therefore, the lessor or lessee remain liable to each other, even if the lease is assigned by one party. If the intention is to safeguard the assignor from future liabilities arising from the contract, all parties to the original contract and the assignee should enter into a novation of the lease. If a novation is not signed, then the assignor may consider procuring an indemnity from the assignee. However, that does not affect the assignor's contractual obligations (as the lessor) towards the lessee under the lease, which includes the lessor's obligation to repay the lease security deposit at the end of the lease term.

Under privity of estate principles, covenants that touch and concern the land will bind third parties. Therefore, assignees are only bound by covenants in the lease if they touch and concern the land. Such covenants include repairing covenants, user covenants and covenants for quiet enjoyment. This is beneficial from a lessor's perspective, because the lessor's assignee (in becoming the new owner of the property) would be obliged to perform or observe such covenants that touch and concern the land under the privity of estate principles, thus, releasing the lessor from his or her obligations.

vi Repair and insurance

Unless the parties agree otherwise, the lessee is obliged to maintain the premises in a good and tenantable condition and the lessor is usually responsible for structural repairs such as concealed wires and pipes drainages. While there is no statutory or regulatory requirement to procure property insurance, it is prudent and advisable for both the lessor and lessee to ensure that there is adequate insurance coverage for the property. Some commercial leases stipulate that insurance coverage must be procured by the lessee for a minimum threshold on any single claim.

vii Termination

There are a number of ways in which a lease may be terminated, including expiration of term, by notice or through an express condition, power or option provided in the lease. A breach of a condition or a covenant with a proviso for re-entry will allow the lessor to terminate the agreement by forfeiture; however, the lessee may be able to apply for relief from the court. A lessee can also repudiate the lease and if the repudiation is accepted by the lessor, the lease will immediately terminate and the lessor will be entitled to sue for damages.

viii Security of tenure

In 2004, several sections of the Landlord and Tenant (Consolidation) Ordinance were amended with the effect of abolishing security of tenure of residential tenancies and leases created after 9 July 2004.

VII DEVELOPMENTS IN PRACTICE

i The Residential Properties (First-hand Sales) Ordinance

The Residential Properties (First-hand Sales) Ordinance came into effect in April 2013 and sets out detailed requirements in relation to the conduct and materials used for selling first-hand residential properties concerning, *inter alia*, sales brochures, price lists, show flats, disclosure of transaction information, advertisements, sales arrangements, and mandatory provisions for preliminary sale and purchase agreements and formal sale and purchase agreements.

Recently, the government successfully brought charges against developers for violating the Residential Properties (First-hand Sales) Ordinance. These charges involved lack of information in and transparency of the sales brochures, failure to include certain mandatory provisions in preliminary sale and purchase agreements and general malpractice contrary to the ordinance. Penalties for breach of the ordinance include fines and imprisonment.

ii Ad valorem stamp duty

As noted above, with effect from 5 November 2016, the AVD chargeable for residential properties has been increased to 15 per cent, subject to existing exemptions. The AVD for non-residential properties will remain at Scale 1 rates (of up to 8.5 per cent) and exempted transactions enjoy the lower Scale 2 rates (up to 4.25 per cent).

A major exemption is where a Hong Kong permanent resident acquires a residential property for the first time or disposes all other residential properties in Hong Kong within six months. However, such exemption would not be available for an acquisition of more than one residential property under a single instrument executed on or after 12 April 2017.

VIII OUTLOOK AND CONCLUSIONS

Despite AVD being increased to 15 per cent in November 2016, the residential property market remained very busy in 2017, with record breaking prices. Some property analysts anticipate that the transaction volumes and housing prices will remain strong in 2018 owing to pent-up demand, low interest rates and persistent housing shortage. The tightened AVD policy signals that the Hong Kong government is closely observing the property market and is determined to introduce more cooling measures if necessary.

As an international city with an open economy and a currency pegged to the US dollar,[7] Hong Kong is susceptible to international macroeconomic developments. The Hong

7 The Hong Kong dollar is officially pegged to the US dollar at US$1 = HK$7.80 and is allowed to trade within a narrow band of US$1 = HK$7.75 to 7.85.

Kong government takes active roles to promote a stable balance in the property market. For example, the Chief Executive of Hong Kong proposed a 'Starter Home' scheme that will provide incentives including lower land premium and shorter processing period to developers to convert their farmland to residential properties in the 2017 Policy Address.

While the retail property market witnessed somewhat of a slump in the beginning of 2017 owing to decreased inbound tourism and diminishing retail sales in the luxury sector, it has largely bounced back up in the latter half of the year due to increased spending incentives. The palpable decline of high-street rental in major districts seen in the early months of 2017 has also slowed, with rents dropping at a significantly lower rate in Q3 than in previous quarters. Many high-profile commercial property transactions have also taken place in 2017. For example, in November 2017, Link REIT announced its disposal of a portfolio of properties, including 17 shopping malls, to a consortium of purchasers (comprising of Gaw Capital Partners, Goldman Sachs Group Inc and China Great Wall Asset Management Co) for HK$23 billion. The sale may represent the recovery of demand in Hong Kong's retail property market.

In the industrial property market, a revitalisation scheme implemented by the Hong Kong Lands Department, which ran from 2010 to 2016, relaxed the usage restrictions on industrial buildings in Hong Kong in order to facilitate the redevelopment of industrial buildings. For a long time, industrial buildings in Hong Kong suffered from a high vacancy rate due to the migration of Hong Kong's manufacturing activity into Mainland China, rendering valuable land resources underutilised in the city. The scheme allowed owners of industrial buildings to convert their properties into commercial buildings without having to pay hefty land premiums. In August 2017, the Development Bureau of Hong Kong stated that it will consider relaunching the revitalisation scheme.[8] While a reprise of the revitalisation scheme would be a welcome development in terms of a more efficient allocation of land resources and opening up more land for various uses, it is also likely to increase rent prices in the industrial property market. The industrial investment market was also active in 2017; in Q3 alone, there were a number of industrial property en block transactions.

The outlook of the Hong Kong property market for 2018 may share similarities with that of 2017. Despite the tightened government policies, transaction volumes at prices hitting all-time highs supports the view that the Hong Kong property market is still attractive for investors and there is still strong demand for Hong Kong real estate.

8 The government of the Hong Kong Special Administrative Region, 'Industrial building plan under study' (16 August 2017): http://www.news.gov.hk/en/categories/infrastructure/html/2017/08/20170816_165321.shtml.

Chapter 17

INDONESIA

Ayik Candrawulan Gunadi and Rio Armando Girsang[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

Land and properties in Indonesia are generally governed by the Indonesian Agrarian Law,[2] which is quite a complex law reflecting and adopting customary (adat) law developed over hundreds of years at rural village level, and as further modified by Dutch colonial rule. Prior to the issuance of the Agrarian Law, adat law and Western law coexisted, governing land registration for Indonesians and foreigners respectively. The Agrarian Law aimed to create a uniform regime and end the dualism on land matters, while still maintaining the communal concepts applicable to land under adat law.

Under the Agrarian Law, the state is authorised to determine the proper use of land, the relationship between land and individuals or groups of individuals, and the consequences of legal actions concerning land.[3]

In general, land status can be divided into two groups, namely state land and private land. For the latter, the Agrarian Law introduced the classification of land rights and a registration system, which has resulted in the issuance of land certificates by the National Land Agency (BPN). A land certificate is considered the strongest evidence of a land title right under Indonesian law, and records, among others, the land title right, name of the title holder, the land area, the title period, the issuance date and security interests created upon the land. Regardless of the land registration system introduced by the Agrarian Law, significant parts of private land in Indonesia remain unregistered and thus uncertificated. Often the only documentation available to support a claim of right is the *girik* right, which is not evidence of title but rather a land tax receipt evidencing that the 'holder or possessor' of the land has paid the tax for the land in question. While this often creates certain deficiencies in terms of legal certainty, in practice, in the absence of a valid land right certificate, the *girik* letter, supported by certain other supporting documents (such as statement letters issued by the local sub-district head, district head or village head confirming the history of the land) are accepted as an indication of 'ownership by possession' to such uncertificated land.

The most common land title rights in Indonesian practice are as follows.

1 Ayik Candrawulan Gunadi is a partner and Rio Armando Girsang is an associate at Ali Budiardjo, Nugroho, Reksodiputro.
2 Law No. 5 of 1960 on Agrarian Law (the Agrarian Law).
3 Article 2, paragraph 2 of the Agrarian Law.

i Right of ownership (hak milik or freehold)

Hak milik is a right that gives the holder the fullest right a person can possess over land in Indonesia.[4] There is no time limit on the land. Only Indonesian citizens and certain limited Indonesian legal persons or entities may hold a *hak milik*.[5] A limited liability company (PT), including a foreign investment company (PMA company), is not allowed to hold a hak milik. If, under certain circumstances, the holders of a *hak milik* are foreigners including PMA companies, they must convert the *hak milik* into other rights; for example, a *hak guna usaha* (HGU)or *hak guna bangunan* (HGB) (as explained below).[6]

ii Right to build (HGB)

The HGB is the most common and typical land title held by a PMA company conducting real estate business in Indonesia. An HGB is a right created over state land, a *hak milik* or a *hak pengelolaan* (a right obtained from the state to control land) authorising the holder to utilise the land, specifically to construct buildings or facilities (as opposed to land specifically intended for agricultural purposes; see the HGU, explained below).[7] An HGB can be granted for a maximum period of 30 years, with possible extension of 20 years[8] and renewal.[9] An HGB may be held by Indonesian individuals and Indonesian legal entities, including a PMA company,[10] and is transferable to other eligible third parties during the term of its existence and can be encumbered with a mortgage, all of which are subject to registration with the relevant land office.[11]

iii Right to cultivate (HGU)

The HGU is a right created over state land, authorising the holder to utilise the land for agriculture or plantation purposes.[12] Like the HGB, the HGU is limited in duration, and is usually for 25 years but can be for a maximum of 35 years, with the option of extension for a maximum of 25 years[13] and renewal.[14] An HGU may be held only by Indonesian individuals or Indonesian legal entities, including PMA companies,[15] and is transferable to other eligible third parties during the term of its existence[16] and can be encumbered with a mortgage as a security.[17] The transfer and the creation of a mortgage upon an HGU must be registered with the relevant land office.[18]

4 Article 20, paragraph 1 of the Agrarian Law.
5 Article 21, paragraphs 1 and 2 of the Agrarian Law.
6 Article 21, paragraph 3 of the Agrarian Law.
7 Article 35, paragraph 1 of the Agrarian Law in conjunction with Article 21 of Government Regulation No. 40 of 1996 on the Right to Cultivate, Right to Build and Right to Use Land (GR No. 40/1996).
8 Article 35, paragraphs 1 and 2 of the Agrarian Law.
9 Article 25, paragraph 2 of GR No. 40/1996.
10 Article 36, paragraph 1, point b of the Agrarian Law.
11 Article 33, paragraph 1 of GR No. 40/1996.
12 Article 28, paragraph 1 of the Agrarian Law.
13 Article 29, paragraphs 1 and 2 of the Agrarian Law.
14 Article 8, paragraph 2 of GR No. 40/1996.
15 Article 30, paragraph 1 of the Agrarian Law.
16 Article 28, paragraph 3 of the Agrarian Law.
17 Article 33 of the Agrarian Law.
18 Article 15, paragraph 1 and Article 16, paragraph 3 of GR No. 40/1996.

iv Right of management (hak pengelolaan)

A *hak pengelolaan* is a right obtained from the state to control land. A *hak pengelolaan* can be granted only to the following agencies or bodies:

a government agencies including regional governments;
b state-owned companies;
c regional government-owned companies;
d limited liability state-owned companies;
e special-authority agencies; and
f other governmental legal entities appointed by the government.

Some state-owned companies manage industrial estate compounds with a *hak pengelolaan*. When such state-owned companies 'sell' *hak pengelolaan* land to PMA companies, the state-owned company as the seller and the PMA company as the buyer will enter into a cooperation agreement, by which the PMA company is granted the right to 'use or utilise land' and to apply for a HGB title over the *hak pengelolaan* land. An HGB created over *hak pengelolaan* land may be mortgaged to a third party, provided that consent is given by the state-owned company. In practice, the consent is usually given in advance and included in the above-mentioned cooperation agreement.

v Right to use (hak pakai)

The *hak pakai* is a right to utilise land or to collect the products from such land. It may be granted over:

a state-owned land;
b *hak milik*; or
c *hak pengelolaan*.[19]

Hak pakai is available to Indonesian citizens and Indonesian legal entities, foreign citizens who reside in Indonesia and foreign legal entities having representation in Indonesia, representatives of foreign countries and representatives of international institutions, departments and non-departmental government institutions, regional government, and religious and social institutions.[20] *Hak pakai* is limited in duration (i.e., it is based on either a decree of the BPN or a contract between the *hak milik* holder and the *hak pakai* holder). A *hak pakai* is transferable and may be granted as security by way of a mortgage[21] but is in any case subject to consent from the state or the holder of the *hak pengelolaan* or *hak milik* (as the case may be).[22]

II OVERVIEW OF REAL ESTATE ACTIVITY

The text below provides an overview of real estate activity with regard to apartments and condominiums.

19 Article 41 of GR No. 40/1996.
20 Article 39 of GR No. 40/1996.
21 Article 53, paragraph 1 and Article 54, paragraph 2 of GR No. 40/1996.
22 Article 43 of the Agrarian Law.

i General

Statistics show that the real estate sector ranked the highest for investment in Indonesia's tertiary sector during the fourth quarter of 2016,[23] indicating that real estate business is an attractive sector for investors in Indonesia. Unfortunately, this positive trend is not yet fully supported by a well-established regulatory system, as certain real estate or licensing provisions may be subject to multiple interpretations, leading to uncertainty in some areas. The practice of 'unwritten policies' adds to the complexity of the licensing requirements for real estate business in Indonesia.

The following discussions elaborate, from a legal perspective, the basic requirements and some of the challenges that investors need to anticipate in the real estate sector in Indonesia, particularly in relation to apartment and condominium business in Jakarta.[24]

ii Land acquisition

Land acquisition is one of the most problematic issues in real estate activities in Indonesia.

Indonesian law recognises two types of land acquisition: acquisition of unregistered and uncertified land, and acquisition of registered land. To acquire land, a PMA company is required to first obtain a location permit (except under certain circumstances whereby the PMA company is exempted from the requirement). A location permit basically authorises the PMA company to acquire the land and to obtain a land title (commonly to be completed within three years, with the possibility of a one-year extension provided that at least 50 per cent of the total area has been acquired). A location permit merely provides a right for the PMA company to acquire the land; it does not, therefore, oblige the PMA company to acquire all of the land set by the location permit, nor does it oblige the landowner to sell his or her land to the PMA company. The maximum area of land that the PMA company is permitted to acquire is stated in the location permit.[25]

Specifically for the Jakarta area, the location permit is granted for a period of six months as of its issuance, thus the land acquisition shall be completed within that period. Should the period end, the location permit shall expire automatically unless otherwise extended in writing by the DKI Jakarta governor.[26]

Acquisition of unregistered land is more challenging than acquisition of registered land because it is difficult for investors to run a complete and thorough background check of the history of the land, including its history of legal ownership and environmental documents. Acquisition of unregistered land is commonly completed through a private sale between the landowner and the purchaser, though it should be noted that a deed of transfer signed before a certified land-deed official (PPAT) at the location of the land is required for registration to the relevant land office, while acquisition of registered land is commonly completed through a deed of transfer before a PPAT at the location of the land, followed by the registration

23 Indonesia Investment Coordinating Board, 'Statistic of Foreign Direct Investment Realisation Based on Capital Investment Activity Report (LKPM) by Business Sector, Q4 – 2016'.

24 Outside Jakarta other regional governments may impose different or additional requirements or different policies.

25 Regulation of the Minister of Agrarian and Spatial Planning/Head of National Land Agency No. 5 of 2015 as amended by Regulation of the Minister of Agrarian and Spatial Planning/Head of National Land Agency No. 19 of 2017 on Location Permit.

26 Regulation of Governor of DKI Jakarta No. 209 of 2016 on the Permit and Recommendation of Spatial Utilization (Regulation No. 209/2016).

and recordation of the transfer with the relevant land office where the land is located. For registered land, investors usually conduct a land check or due diligence review at the district courts and the relevant BPN office prior to completion of the transaction, to enable them to identify any existing disputes and encumbrances, and to review the history of transfer of the land.

iii Material building and utilisation permits

Spatial Utilisation Principle Licence (IPPR)

An IPPR (previously known as an SIPPT) is a specific permit issued by the Jakarta regional government for the utilisation of certain space in the Jakarta area, including for the construction of an apartment building. An IPPR, normally imposes obligations on the holder to construct social facilities and pay a contribution to the local government.[27]

As a general rule, a licence or permit, including an IPPR, is an individual document granted specifically to its holder based on the assessment made by the governmental authority. Given its 'individual nature', from a regulatory perspective such a permit or licence is strictly non-transferable and may not be used by any person other than its registered holder.[28] However, in practice, it is not uncommon that an IPPR is used by several companies with respect to land located in the same area. From the legal perspective, ideally a new IPPR or amendment to the existing IPPR is obtained to reflect the 'new' owners of the land whenever the land is transferred. Such a case, however, raises the legal question of whether the new owner is obliged to construct new social facilities and pay an additional contribution to the local government; this question is particularly relevant where the previous owner has already fulfilled all of these requirements.

Building permit (IMB)

The IMB Regulations[29] require all parties to obtain an IMB before constructing a building. An IMB authorises its holder to construct, alter, expand, reduce in size or maintain a building structure in accordance with the applicable administrative and technical requirements.[30] It is stated in the text of the IMB Regulations that the IMB will be issued within 25–30 business days of the payment of a contribution fee being made.

27 Decree of Governor DKI Jakarta No. 41 of 2001 on Receipt of Obligation Procedures for SIPPT Holders in DKI Jakarta, and Decree of Governor of DKI Jakarta No. 139 of 1998 on the Procedures for Application and Completion of Land Nomination and Utilization Permit for Foreign and Domestic Investment Companies in DKI Jakarta in conjunction with Regulation of Governor of DKI Jakarta No. 209 of 2016 on the Permit and Recommendation of Spatial Utilization (Regulation No. 209/2016).

28 Article 29 of Regulation of Governor of DKI Jakarta No. 209 of 2016 on the Permit and Recommendation of Spatial Utilisation (Regulation No. 209/2016) explicitly provides that an IPPR is not transferable.

29 Law No. 28 of 2002 on Building Structure (Law No. 28/2002) and its implementing regulation, Government Regulation No. 36 of 2005 on the Implementing Regulation of Law No. 28 of 2002 on Building Structure (GR No. 36/2005); Regulation of Minister of Internal Affairs No. 32 of 2010 on Guidelines for the Issuance of Building Construction Permits (MR No. 32/2010); DKI Jakarta Regional Government Regulation No. 7 of 2010 on Building Structure (Regulation No. 7/2010); and Regulation of Governor of DKI Jakarta No. 128 of 2012 on Sanctions for the Implementation of Building Structure (Governor Regulation No. 128/2012); Law No. 28/2002, GR No. 36/2005, MR No. 32/2010, Regulation No. 7/2010, and Governor Regulation No. 128/2012 collectively, the IMB Regulations.

30 The IMB Regulations.

In the Jakarta area, to facilitate a speedy licensing process, the Jakarta local government now issues a 'preliminary licence', which serves as a temporary licence for the construction of certain parts of the building while awaiting the actual IMB to be issued.[31]

Occupancy permit and certificate of 'good function'

There are two existing regulations requiring a developer to obtain a specific permit before operating or utilising an apartment. The Apartment Regulations[32] require developers to obtain an occupancy permit and Regulation No. 7/2010 requires developers to obtain a certificate of good function,[33] both issued by the DKI Jakarta government. Neither the Apartment Regulations nor Regulation No. 7/2010 have been revoked, and, therefore, legally speaking, both requirements are still valid. In practice, however, to the best of our knowledge, the DKI Jakarta government seems not to implement the Apartment Regulations. An official of the DKI Jakarta regional government has explained that the DKI Jakarta government currently only issues the certificate of good function and not the occupancy permit.

Environmental permit

All building constructions, including condominiums, require the preparation of certain environmental documents.[34] The Indonesian Environmental Law[35] distinguishes several categories of documents and permits, depending on the impact of the construction. For those deemed to have a significant impact on the environment, the PMA company must prepare an environmental impact analysis report (AMDAL), while for constructions deemed to have a less significant impact on the environment, an environmental management and monitoring efforts report (UKL/UPL) or a statement of environmental management and monitoring undertaken (SPPL) is needed. In addition, those required to prepare an AMDAL or UKL/UPL must also obtain an environmental licence. For condominiums, depending on their size and location, the requirement is to obtain the approval of AMDAL or UKL/UPL, and the environmental licence.[36]

Requirement to construct a general condominium

Law No. 20 of 2011 on Condominium, and Regulation of Minister of Public Housing No. 10 of 2012 on Implementation of Housing and Settlement Area with Balanced Occupancy (as further amended)[37] (the Condominium Regulations) requires every developer constructing

31 Article 44 of Regulation of the Governor of DKI Jakarta No. 129 of 2012.
32 Government Regulation No. 4 of 1988 on Apartments; Jakarta Regional Government Regulation No. 1 of 1991 on Apartments in DKI Jakarta; and Governor of DKI Jakarta Decree No. 942 of 1991 on the Implementing Regulation for Apartments in DKI Jakarta; collectively, the Apartment Regulations.
33 Article 148 of Regulation No. 7/2010.
34 Article 52 of Regulation No. 7/2010.
35 Law No. 32 of 2009 on Environmental Management and Protection (Law No. 32/2009).
36 Decree of Governor of DKI Jakarta No. 189 of 2002 on Business That Requires UKL/UPL in DKI Jakarta; and Decree of Governor of DKI Jakarta No. 2863 of 2001 on Business That Requires AMDAL in DKI Jakarta.
37 Regulation of Minister of Public Housing No. 07 of 2013 on the Amendment to Regulation of Minister of Public Housing No. 10 of 2012 on Implementation of Housing and Settlement Area with Balanced Occupancy (Minister Regulation No. 7/2013).

a commercial condominium[38] to construct also a general condominium.[39] The total floor area of the general condominium must be at least 20 per cent of the total floor area of the commercial condominium.[40] This requirement significantly affects investors, and their investments, in Indonesia. Commonly, the requirement to construct a general condominium will be stipulated in the IPPR.

III FOREIGN INVESTMENT

In general, the most common practice for investment in real estate business in Indonesia is to set up a PMA company because foreign citizens and entities are not allowed to conduct business activities directly in Indonesia. The following paragraphs highlight the general rules on ownership of the most common land title rights in Indonesia, including the one that may be held by a PMA company.

i Right of ownership (hak milik or freehold)

Only Indonesian citizens and certain limited Indonesian legal persons or entities may hold the right of ownership (*hak milik*).[41] A limited liability company (PT), including a PMA company, is not allowed to hold a right of ownership.

ii Right to build (HGB)

An HGB may be held by Indonesian individuals and Indonesian legal entities, including a PMA company.[42]

iii Right to cultivate (HGU)

An HGU may only be held by Indonesian individuals or Indonesian legal entities, including PMA companies.[43]

iv Right of management (hak pengelolaan)

A right of management (*hak pengelolaan*) can be granted only to the following agencies or bodies:

a government agencies including regional governments;
b state-owned companies;
c regional government-owned companies;
d limited liability state-owned companies;
e special-authority agencies; and
f other governmental legal entities appointed by the government.

38 A commercial condominium is defined as a condominium developed for the purpose of gaining profit, with a value exceeding the value of a general condominium.

39 A general condominium is defined as a condominium developed for people on low incomes, the rate of the sales value for which – for the Jakarta Selatan area, for example – is a maximum of 331.2 million rupiah per unit or 9.2 million rupiah per square metre.

40 Article 9a, paragraph 5 of Minister Regulation No. 7/2013.

41 Article 21, paragraphs 1 and 2 of the Agrarian Law.

42 Article 36, paragraph 1, point b of the Agrarian Law.

43 Article 30, paragraph 1 of the Agrarian Law.

Some state-owned companies manage industrial estate compounds with a *hak pengelolaan*. When such state-owned companies 'sell' *hak pengelolaan* land to PMA companies, the state-owned company as the seller and the PMA company as the buyer will enter into a cooperation agreement, by which the PMA company is granted the right to 'use or utilise land' and to apply for a HGB title over the *hak pengelolaan* land.

v Right to use (hak pakai)

The right to use (*hak pakai*) may be granted over:

a state-owned land;

b *hak milik*; or

c *hak pengelolaan*.[44]

The right to use (*hak pakai*) is available to Indonesian citizens and Indonesian legal entities, foreign citizens who reside in Indonesia and foreign legal entities having representation in Indonesia, representatives of foreign countries and representatives of international institutions, departments and non-departmental government institutions, regional government, and religious and social institutions.[45]

IV STRUCTURING THE INVESTMENT

Foreign citizens and foreign companies are not allowed to conduct business activities directly in Indonesia. Indonesian investment law requires foreign investment to be conducted through direct capital participation in a PMA company.[46] Therefore, the most common practice for investment in real estate business is to set up a joint venture project company in the form of a PMA company in Indonesia.

General foreign investment in Indonesia is subject to certain limitations under the Negative Investment List[47] (a list of the business areas that are closed to investment, including those reserved for small and medium-sized enterprises), which is updated periodically by the government. Based on the prevailing Negative Investment List, real estate business (i.e., purchasing, selling, renting and operating either owned or rented real estate, as well as land sales and operational activities in residential areas) is open to 100 per cent foreign participation. The Indonesia Investment Coordinating Board, the government institution authorised to supervise investment in Indonesian,[48] has very broad discretionary power to grant investment licences to PMA companies, which extends to applying unwritten policies with respect to investments.

44 Article 41 of GR No. 40/1996.

45 Article 39 of GR No. 40/1996.

46 Article 5, paragraph 2 of Law No. 25 of 2007 on Investment (the Investment Law).

47 Presidential Regulation No. 44 of 2016 on List of Business Fields Closed and Business Fields Open with Conditions to Investment (the Negative Investment List).

48 Article 27, paragraph 2 of the Investment Law.

V REAL ESTATE OWNERSHIP

i Planning

Every building must have a function and classification. The law divides function and classification of a building into five types, namely residential function, religious function, business function, social and cultural function, and special function.[49] When planning an apartment or condominium development, the PMA company must ensure that the function and classification of the apartment building is in line with the zoning regulation or the city plan guidelines.[50] Amendments to the apartment function and classification can be made so long as the new function and classification are in line with the zoning regulation or the city plan guidelines and must be reflected in the PMA company's IMB.[51]

ii Tax

Any acquisition of a land title is subject to 5 per cent tax, payable by the acquirer promptly upon the execution of the transaction (for example, in a sale and purchase of land, the acquisition tax is payable upon the signing of the land title transfer deed before a PPAT).[52] For any income received from a transfer of land or buildings, in general, the transferor is also subject to 2.5 per cent tax of the transaction price.[53] In practice, it is common that a PPAT will consummate the transaction, but the BPN will not accept the land registration until both acquisition tax and income tax are paid to the government.

iii Finance and security

Security interests in Indonesia are limited to those prescribed by Indonesian law. For land and buildings (including apartments), the type of security interests prescribed by law is the *hak tanggungan* (often translated as 'mortgage'). A *hak tanggungan* is created through the signing of a mortgage deed in the Indonesian language before a PPAT and registration with the BPN office[54] where the land is located.

A *hak tanggungan* only secures debts up to the amount specified in the mortgage deed (secured amount). The secured amount affects the PPAT fee payable by the mortgagor. The higher the secured amount, the higher the PPAT fee (in practice, normally, a PPAT charges 0.1 per cent of the secure amount as his or her fee). Because of its significant impact, the secured amount of a *hak tanggungan* often becomes a major issue in financing transactions, as the creditor will try to push the secured amount to be as high as possible (normally between 120 per cent and 150 per cent of the total outstanding debt), while, in contrast, the debtor will try have the secured amount fixed as low as possible.

A *hak tanggungan* grants a preference right to the holder[55] in the event of the bankruptcy of the mortgagor, and it follows the encumbered property, notwithstanding any transfer of the property, until the debt secured has been paid. Enforcement of a *hak tanggungan* must

49 Article 6, paragraph 2 of Regulation No. 7 of 2010.
50 Article 7 of Regulation No. 7/2010.
51 Article 11 of Regulation No. 7 of 2010.
52 Law No. 28 of 2009 on the Regional Taxes and Dues.
53 Government Regulation No. 34 of 2016 on Income Tax from the Income of Land and/or Building Transfer, and Conditional Sale and Purchase Agreement of Land/or Building including its amendment.
54 Article 10, paragraph 2 and Article 13, paragraph 1 of Law No. 4 of 1996 on Mortgage (the Mortgage Law).
55 Article 1, point 1 of the Mortgage Law.

be done by way of a sale by public auction or private sale. In a public sale or auction, the mortgagee is entitled to apply the proceeds of the auction towards the repayment of any debt.[56] Private sale is allowed based on mutual consent between the mortgagor and mortgagee and if by doing so the highest sale price beneficial for both parties can be achieved. A *hak tanggungan* may not include a provision allowing the creditor to take possession of the property if the debtor is in default.[57]

VI LEASES OF APARTMENT PREMISES

With the exception of the lease of general (low-budget) apartments or apartments constructed using the state or a regional budget, there are no specific requirements for lease and rent of apartments in Jakarta. Therefore, under Indonesian law, an apartment lease is generally a contractual matter.

It has been reported in the news that there is a trend for short-term apartment leases (daily or monthly) in the Jakarta area, as opposed to long-term leases (yearly), which were previously the preferred choice of most apartment lessors. One of the reasons for this is that lessors find short-term leases more profitable as they can charge customers up to twice the average daily price of a yearly lease.[58]

Lessors normally also charge a security deposit to the customer. The amount of the security deposit varies between apartments, depending solely on the lessor's discretion. In one case, a lessor charged 100 per cent of the rent (for a short-term lease) for the security deposit.[59] The security deposit is returned to the customer at the end of the lease period should there be no damage to the premises.[60]

We note that, prior to March 2015, many apartment rents were charged in foreign currency. However, in light of the recent issuance of the Indonesian central bank's regulation requiring all payment transactions in Indonesia to be conducted in Indonesian currency,[61] effective as of March 2015 (for cash transactions) and July 2015 (for non-cash) transactions, all apartment rents must be charged in rupiah. This recent development has had quite a significant impact on the many property companies who receive offshore financing in US dollars, and who were reliant on customers' rent for their financing repayments.

VII DEVELOPMENTS IN PRACTICE

There is an ongoing trend of transit-oriented development (TOD) within the Greater Jakarta area, which is expected to be a part of the Greater Jakarta citizens' lifestyle within the next several years.[62] Several railway infrastructure projects are being developed within

56 Article 6 and Article 20 of the Mortgage Law.

57 Article 12 of the Mortgage Law.

58 http://properti.bisnis.com/read/20130901/49/160025/bisnis-sewa-apartemen-harian-lebih-menguntungkan, published on 1 September 2013.

59 Ibid.

60 Ibid.

61 Bank Indonesia Regulation No. 17/3/PBI/2015 on the Mandatory Use of Rupiah in the Republic of Indonesia and its Circular Letter No. 17/11/DKSP, dated 1 June 2015.

62 http://bisnis.liputan6.com/read/3068235/12-perusahaan-inggris-minati-pengembangan-tod-di-jakarta, published on 23 August 2017.

the Greater Jakarta area, for instance, the Jakarta Mass Rapid Transit and Jakarta Light Rail Transit. Development of transportation infrastructures has encouraged the development of apartments within the surrounding areas.[63] The growth of industrial area in certain area of Greater Jakarta has also encouraged employees to rent apartment near their workplace.[64] In terms of regulatory framework, BPN has recently enacted the Regulation of the Minister of Agrarian and Spatial Planning/Head of National Land Agency No. 16 of 2017 on Guidelines of Transit Oriented Area Development, which sets out guidelines for the central government and regional government in determining and stipulating TOD location, and aims to ensure that transit-oriented area will give added value and create healthy and conducive business climate.

Furthermore, on 26 September 2016, the Minister of Agrarian and Spatial Planning/ Head of National Land Agency has issued the Minister of Agrarian and Spatial Planning/ Head of National Land Agency Regulation No. 29 of 2016 on the Procedure of Granting, Relinquishment, or Transfer of Right of Ownership over House or Residence of Foreign Citizen Domiciled in Indonesia. In general, the regulation provides that, subject to certain requirements, a foreign citizen who validly possesses a stay permit (*izin tinggal*) may own an apartment unit with the Right to Use over Apartment Unit (*hak pakai atas satuan rumah susun*). The regulation encompasses, among other things, the types of apartment unit that foreign citizens may own as well as the transfer and collateralisation of title over the apartment unit, and it is expected to provide legal certainty to foreign citizen.

VIII OUTLOOK AND CONCLUSIONS

Despite growing investment in real estate in Indonesia, the complexity of the regulatory framework, on account of the inconsistencies and unclear regulatory provisions in many aspects of the industry, makes the real estate sector in Indonesia a rather challenging business.

The government's attempts to boost investment in the real estate sector by giving incentives to investors must be done in line with further improvements to the regulatory and enforcement system, by eliminating unclear requirements and unwritten policies. The government needs to synchronise all relevant regulations and implement strictly uniform conduct in relation to regulatory enforcement throughout the various government institutions, from the level of central to regional governments, to create an investment-friendly environment for investors.

63 http://properti.liputan6.com/read/2427696/proyek-lrt-pacu-pembangunan-apartemen-di-pinggiran-kota, published on 3 February 2016.

64 http://properti.liputan6.com/read/3076057/bisnis-sewa-apartemen-di-cikarang-tawarkan-untung-menggiurkan, published on 30 August 2017.

Chapter 18

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, which grants 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.

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

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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 2017, Italy witnessed a sharp increase in the real estate activity compared with previous years, with a significant growth in volumes and the overall number of sizeable transactions (a 20 per cent increase on 2016).

The main driving force behind this turnaround has been the consolidation of the interest of foreign investors, who have significantly increased their presence on the Italian market and are showing a growing appetite, especially for office and commercial real estate.

Foreign investors have made an impressive comeback on the Italian market since 2013, and in 2016 they accounted for over 80 per cent 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.

Investments are concentrating in the more liquid markets of Milan and Rome, with Milan attracting a significant portion of the total investments made in Italy flowed in 2016, which totalled almost €10 billion. The strong competition for core assets in prime locations has led to a decrease in prime yields, and investors are gradually moving up in the risk scale and looking at more opportunistic investments or secondary locations.

III FOREIGN INVESTMENT

Italian law does not impose any significant restriction on foreign ownership of real estate. EU nationals may purchase real estate as freely 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 on assets sales are taxed at the ordinary corporate tax rates: corporate income tax (IRES) at 24 per cent and regional tax (IRAP) at 3.9 per cent. Special rules apply to the deduction of interests (30 per cent earnings before interest, taxes, depreciation and amortisation (EBITDA) 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 investment 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 26 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

Italy has recently modified its REITS regime to promote the listing of new real estate investment companies (SIIQs). Under the new rules, to qualify as a SIIQ the company must be listed on a stock exchange, no shareholder may hold (directly or indirectly) more than 60 per cent of voting and profit rights, and at least 25 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 70 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 capital gains on the sale of leased assets and from investments in 95 per cent-owned real estate subsidiaries and Italian real estate funds (exemption from both IRES and IRAP).

In addition the new law has introduced provisions aimed at facilitating the transfer of assets from real estate funds to SIIQs:

a no capital gains or losses in the hands of the investors on exchanging real estate funds units for SIIQ shares (rollover regime);

b application of a favourable indirect tax regime (i.e., exemption from VAT or registration, mortgage and cadastral taxes) on (1) contributions of a plurality of leased assets from a real estate fund to a SIIQ; and (2) transfer of a plurality of leased assets from a real estate fund to a SIIQ in the context of the liquidation of the real estate fund.

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 a 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: VAT, registration tax, mortgage tax and 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 €200 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 22 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 €200 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]

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).

2 Legislative Decree No. 385/1993.
3 See Article 38(2) of the Banking Act and implementing resolutions.
4 Royal Decree No. 267/1942.

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.

iv Alternative lending

Since 2012 several legislative measures have been enacted to promote alternative lending activity in Italy. These measures have contributed to enhancing the lending market to include players other than banks as lenders. In particular, the direct lending market has been opened to Italian and EU alternative investment funds (AIFs) and securitisation vehicles.

Direct lending by AIFs

Following the implementation in Italy of the Alternative Investment Fund Management Directive, receivables are eligible assets for investment by AIFs, including 'receivables arising from financings granted out of the assets of the AIF'.

Decree-Law No. 18 of 14 February 2016 amended the Italian Finance Act to introduce the following changes:

a Italian AIFs are now authorised to grant loans to borrowers (other than the retail public); and
b EU AIFs are authorised to invest in receivables in Italy and to grant loans, subject to conditions – a specific implementing regulation needs to be issued by the Bank of Italy.

The following apply to direct lending for EU AIFs:

a home regulator authorisation is required;
b the EU AIF may start operations only after 60 days from the notification to the Bank of Italy;
c to operate in Italy, the EU AIF must have a closed-ended form and its operating model must be comparable to that of Italian AIFs;
d risk management, concentration and leverage requirements of the home Member State must be equivalent to those applicable in Italy; and
e regulatory duties in Italy include notification to the Central Credit Register and application of Italian transparency provisions.

Direct lending by securitisation vehicles

Decree-Law No. 91 of 24 June 2014 (known as the Competitiveness Decree) has allowed Italian securitisation vehicles to grant loans to borrowers other than individuals and microenterprises. The relevant Bank of Italy implementing regulations were enacted in March 2016 and provide the following legal framework for direct lending by Italian securitisation vehicles:

a the borrower must be selected by a bank or a financial intermediary;

b the notes issued by the special purpose vehicle can only be underwritten by 'qualified investors'; and

c the bank or financial intermediary that has selected the borrower must retain a significant economic interest in the transaction (i.e., at least 5 per cent) and must comply with the cash reserve ratio requirements.

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. However, the recent 'Unlock Italy' Decree (converted by Law No. 164, 11 November 2014) has liberalised Italian lease law with respect to major commercial lease agreements (see Section VI.viii, below).

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 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, below). 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 an 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 right to a six-month prior-notice termination 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 a 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 a 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 a 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 The recent liberalisation of Italian lease law

The recent Unlock Italy Decree (converted by Law No. 164, 11 November 2014) has liberalised Italian lease law with respect to major commercial lease agreements.

Pursuant to the new law, the parties to commercial lease agreements with annual rent exceeding €250,000 are now free to opt out from the provisions of the Lease Act.

The new law provides that 'the parties to leases agreements for non-residential purposes, and in relation to hotel use, are entitled to agree terms and conditions derogating from the provisions of this law [i.e., the Lease Act], provided that the annual rent of the lease exceeds €250,000 and provided that the lease does not relate to premises declared of historic interest by a decision issued by regions or municipalities'.

The reform is having a significant impact on Italian lease practice. Key aspects of lease agreements (such as minimum duration, automatic renewal, tenants' pre-emption rights, tenants' break rights for 'serious reasons' and the landlord's obligation to pay a goodwill indemnity in the event of the termination of the lease) that were previously regulated by mandatory provisions of the Lease Act can now be freely negotiated between the parties.

ix Land Registry registration and related taxes

According to Article 2643, of the Civil Code, a lease agreement relating to immovable 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

i Recent legal reforms

In 2014 and 2015 Italy introduced market-friendly reforms aimed at modernising the Italian real estate market and attracting foreign investors. These include:

a the liberalisation of Italian lease law, with the option for the parties to commercial lease agreements to freely negotiate contractual terms (see Section VI.viii, above);

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 instrument (see Section IV.iv, above); and

c liberalisation of the lending market, with the promotion of non-banking lending instruments (e.g., liberalisation of the corporate bond regime) and alternative lenders (credit funds, insurance companies and securitisation vehicles) (see Section V.iii, above).

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

There was a significant increase in real estate activity in 2017, mainly driven by the continuing interest of foreign institutional investors in the Italian real estate market. This positive trend is expected to continue in 2018, with volumes driven by the arrival of significant property portfolios on the market from maturing funds, divesting pension funds, banks and other institutional and private investors.

Chapter 19

JAPAN

Norio Maeda, Yasuo Asami and Keisuke Yonamine[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 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

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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, below) are frequently used for real estate investment. Japanese real estate investment trusts (J-REITs) (discussed in Sections IV and VII, below) 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 focus in their global investment strategy.

While the global economic turmoil in the late 2000s 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. Since then, we have seen reversal in prices and transaction volume of real estate. The transaction volume for Japanese real estate in fiscal year 2014 recovered to the level nearly as high as that of fiscal year 2007, the previous watermark for high transaction volume prior to the global economic turmoil. After the transaction volume hit the high end in 2014, the transaction volume was lower in 2015 and 2016. However, the transaction volume in 2015 and 2016 remained at the higher end, nearly as high as that of the fiscal year 2006 before the global economic turmoil began.

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 a qualified corporation for owning agricultural land. It would not be easy for foreign investors to be granted such an 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 (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. The Real Estate Specified Joint Enterprise Act (REJEA) was amended in 2013 to enable a GK-TK structure (see below) to invest into real estate without requiring the GK as the TK operator vehicle itself to obtain a licence.

i GK-TK structure

A limited liability company (GK) is one type of corporate entity 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 REJEA. Therefore, the GK-TK structure has usually been structured to invest in trust beneficial interests in real estate, not in real estate itself. An exemption from the licensing requirement under the REJEA (newly introduced in 2013) allows the GK-TK structure to invest in 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 (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 (the requirements to qualify as a QII are now stricter after the amendment to the relevant cabinet order and cabinet office ordinance under the FIEL, which became effective on 1 March 2016);

b the number of non-QII TK investors (if any) is 49 or less (non-QIIs are limited to certain categories, which includes a foreign corporation, after the 1 March 2016 amendment to the relevant cabinet order and cabinet office ordinance under the FIEL, while there were no limitations imposed on non-QIIs before the amendment);

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 notification regarding the QII exemption (the requirements for the notification to be filed by the GK are now more complex, compared to the previous simple requirements).

As noted above with respect to the relevant requirements, the requirements of the QII exemption were amended in 2016 (further discussed in Section VII, below).

Another exception available under the FIEL is the exemption by outsourcing to a registered discretionary investment manager. Under this exemption, the GK retains a registered discretionary investment manager (a 'registered financial instruments operator' under the FIEL) as its asset manager to manage its trust beneficial interest in real estate on a discretionary basis. This exemption requires, among other items, that:

a the GK enters into a discretionary asset management agreement with the registered discretionary investment manager that authorises the manager to make a discretionary investment decision on behalf of the GK on its trust beneficial interest in real estate;

b the TK agreement provides that under the asset management agreement described above, the GK authorises the manager to make a discretionary investment decision on its behalf on its trust beneficial interest in real estate;

c the TK agreement provides an outline of the asset management agreement described above, including the fees (or the fee arrangement) to be paid to the asset manager from the assets managed under the GK-TK structure;

d both the TK agreement and the asset management agreement both described above provide certain duties of the asset manager, such as the asset manager's duty of loyalty and duty of care of a prudent manager both owed to the TK investor in carrying out the investment management of the trust beneficial interest in real estate held by the GK;

e the GK manages its assets of the GK-TK separately from its own assets (and its other investment assets managed for other investors, if any) and the asset manager supervises such separate management; and

f the asset manager files a notification to the authority of the outsourcing by the GK prior to the GK entering into the TK agreement.

REJEA structure

Since the 2013 amendment to the REJEA, 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. It is hoped that this GK-TK structure under the REJEA will enhance investment into real estate without the need to involve a trustee in respect of a trust beneficial interest at the underlying real estate level. The most recent amendment in 2017 to the REJEA has also made certain changes to the GK-TK structure and its requirements.

The GK-TK structure under the REJEA essentially requires that:

a the GK must be established for the sole purpose of distributing proceeds and profits from transactions related to the subject real estate;

b the GK as the TK operator delegates (1) the management of transactions related to the subject real estate to a real estate specified joint enterprise business operator (REJEB operator) that is licensed to conduct its business under Article 2, paragraph 4, item 3 or Article 2, paragraph 6, item 2 of the REJEA, and (2) the solicitation of investments into the TK operator by the TK investor (or investors) to a REJEB operator that is licensed to conduct its business under Article 2, paragraph 4, item 4 of the REJEA;

c 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, if the TK operator is to conduct the development of land as a site for buildings, construction of a building, or repair or renovation of a building, the cost of which exceeds 10 per cent of the value of the real estate held by the TK operator (or exceeds ¥100 million if the REJEB operator retained by the GK is an operator of a 'Small-Sized Real Estate Specified Joint Enterprise' as described in Article 2, paragraph 6, item 2 of the REJEA); and

d the agreement for (1) as described in (b) above to be entered into between the GK and the REJEB operator must stipulate certain items specified under the REJEA.

Under these requirements, the 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 in (b) above. To enhance the use of this GK-TK structure under the REJEA, a GK-TK structure satisfying the above-mentioned requirements will benefit from reduced registration and licence tax, and real estate acquisition tax. For more details on the reduction of these taxes, see Section V, below.

Also see Section VII, below, with respect to the 2017 amendment to the REJEA. The REJEB operator mentioned in (b) above can be an operator of a Small-Sized Real Estate Specified Joint Enterprise, newly introduced under the 2017 amendment to the REJEA. After the 2017 amendment to the REJEA, the GK-TK structure can also be set up using the framework of the investment arrangement to be invested only by 'super professional investors' as described in Section VII, below, not the GK-TK framework as described above that has been available since the 2013 amendment to the REJEA.

ii TMK structure

A TMK incorporated under the Asset Liquidation Law (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 the 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 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 (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) 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 the 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 the ownership title to real estate requires a stamp tax of progressive amounts generally ranging from ¥200 to ¥600,000, based on the purchase price provided in the agreement. A range from ¥200 to ¥480,000 will apply to an agreement entered into between 1 April 2014 and 31 March 2018.

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 a registration regarding a transfer of land occurring between 1 April 2013 and 31 March 2019, and a rate of 0.15 or 0.3 per cent will apply to a transfer of ownership title to certain qualified residential buildings that are acquired by an individual by 31 March 2020, to be used for residential purposes.

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); provided that the reduced tax rate of 1.5 per cent will apply to residential lands that are acquired by 31 March 2018.

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 2019 will be reduced to 1.3 per cent; and

b the real estate acquisition tax rate is currently two-fifths of the original rate, and this reduced rate will apply until 31 March 2019.

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 the 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 or 0.4 per cent (for land), or 0.4 per cent (for buildings); and

b on the 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 the transfer of the trust beneficial interest.

However, when the holder of a trust beneficial interest in real estate (other than the initial holder) 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 registration of the real estate transfer. Upon such a 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 under the REJEA

If a GK-TK structure under the REJEA (as discussed in Section IV, above) acquires one or more of (1) an old building to be rebuilt or renovated (defined as a building older than 10 years or a building seriously damaged by natural disasters), (2) land used for a building that is to be rebuilt or renovated, and (3) land planned to be used for a building newly built on the land; 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 2019 will be reduced to 1.3 per cent; and

b the real estate acquisition tax rate is currently half of the original rate, and this reduced rate will apply until 31 March 2019.

Notwithstanding the above, if a GK-TK structure is used for a Small-Sized Real Estate Specified Joint Enterprise (discussed in Section VII, below), the following real estate acquired by the GK-TK structure may qualify for the following tax benefits if it meets certain other requirements:

a the registration and licence taxes for registration of a building acquired until 31 March 2019 for the purpose of rebuilding or renovating will be reduced to 1.3 per cent; and

b the real estate acquisition tax rate for a building constructed before 1 January 1982 and acquired for the purpose of rebuilding or renovating, and the land acquired as the site of the building is currently half of the original rate, and this reduced rate will apply until 31 March 2019.

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 a 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 (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 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 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 2017 amendment to the REJEA

On 1 December 2017, an amendment to the REJEA came into effect. The amendment was made to: (1) ease restrictions under the REJEA and encourage investment into small-sized real estate; (2) revise the rules to enhance investment into and accumulation of improved quality real estate; and (3) formulate an appropriate legal framework for fundraising through crowdfunding.

Establishment of a small-sized real estate investment business

To enable a wide range of local real estate business operators to engage in the revitalisation of vacant houses and stores, a project with a predetermined investment total amount that is, in general, lower than ¥100 million (¥1 million for each general investor and ¥100 million for each 'special investor') is now categorised as a Small-Sized Real Estate Specified Joint Enterprise. Operators of a Small-Sized Real Estate Specified Joint Enterprise are not required to obtain a licence under the REJEA, but are required to register as an operator of a Small-Sized Real Estate Specified Joint Enterprise in accordance with the REJEA. The operators are subsequently required to renew their registration every five years. This Small-Sized Real Estate Specified Joint Enterprise framework is anticipated to improve the revitalisation of vacant houses and stores in local cities.

Revision of the rules to enhance investment into and accumulation of improved quality real estate

A new type of real estate investment arrangement is introduced under the 2017 amendment to the REJEA. If the investors in such investment arrangement comprise only 'super professional investors', such as REJEB operators and real estate investment advisers with sufficient knowledge and capability to qualify for appointment as a discretionary investment adviser, this investment arrangement does not subject the operator who receives the investment from the investors to the licensing requirements. However, the operator is required to submit a notice to the relevant authority in accordance with the REJEA. This new type of investment arrangement simplifies the procedures required to be taken by operators of a real estate investment business and is anticipated to increase investment into and accumulation of improved quality real estate in Japan.

Formulation of appropriate legal framework for fundraising through crowdfunding

The amended REJEA addresses fundraising through crowdfunding, as there is a material difference in the method in which fundraising through crowdfunding is conducted. As crowdfunding is normally conducted electronically through online portals on the internet, the amended REJEA addresses specific electronic procedures to be taken by the operator of a real estate investment business under the REJEA, including the provision of electronic data to the investors under a designated method, which is an exception to the requirement that the operator deliver paper materials to the investors. The operator soliciting funds through crowdfunding or on an electronic basis is also required to set up an internal framework to monitor its operations to engage in such solicitation, and to ensure that such operations are conducted properly.

ii Residence Lodging Business Act

In response to the increase in the demand for accommodation in large cities owing to the increase of foreign visitors to Japan, a need to utilise home-sharing services provided by private citizens (i.e., services to provide home-sharing services to visitors at a residence, not a hotel or a traditional Japanese inn) has arisen (Home-Sharing Services). However, as the use of the Home-Sharing Services has increased rapidly prior to the establishment of regulations in this area, it is essential that rules to appropriately regulate the Home-Sharing Services be created in order to manage public health, prevent disturbances within local communities, and restrict the illegal operation of hotel businesses.

For this purpose, the Residence Lodging Business Act (RLBA) was passed in 2017 and will come into effect on 15 June 2018.

Effect of the RLBA

The Home-Sharing Services recognised under the RLBA include: (1) provision of Home-Sharing Services to a visitor in the room of a home whose owner is a resident; and (2) in the case of leased premises, provision of Home-Sharing Services to a visitor during the period of solicitation of new tenants after the termination of a lease with the former tenant.

Investors who own and lease real estate have the option to provide Home-Sharing Services to visitors during the period from the termination of a lease with the former tenant until a new tenant is found. This option under the RLBA would not enable real estate investors to use their real estate solely to offer the Home-Sharing Services. Despite the restrictions of the RLBA, there may be a demand in the real estate market in the future for the development of methods to allow investors to maximise the value of their real estate investment through the relaxation of the regulations by allowing more frequent use of the Home-Sharing Services.

In this respect, the Japanese government has designated several special districts where operators are allowed to provide the Home-Sharing Services. Operators may wish to consider using their investment real estate in the designated special districts solely for the purpose of offering the Home-Sharing Services.

Summary of the regulations under the RLBA

The specific regulations under the RLBA can be summarised as follows:

a a person who will provide the Home-Sharing Services must file a notice with the prefectural governor before starting the provision of the Services;

b the RLBA limits the number of days in which an operator can provide the Home-Sharing Services to 180 days per year for each room. However, the number of days may differ for each local district, and as a result, there is no guarantee that a room can be used to provide the Home-Sharing Services for 180 days anywhere in Japan;

c if the owner lives in the same home (i.e., a 'home-stay'), the owner shall take appropriate measures in order to properly provide the Home-Sharing Services, such as ensuring the protection of health, preventing noise, dealing with complaints, preparing a list of guests, and posting signs;

d if the owner does not live in the same home, the owner shall delegate a management company to take the measures described in (c) above in order to properly provide the Home-Sharing Services;

e the management company mentioned in (d) above must be registered with the authority under the RLBA; and

f the broker of the Home-Sharing Services shall be registered with the authority under the RLBA.

iii Amendment to the Civil Code

The amended Civil Code will come into effect on 1 April 2020. The law of such amendment was already enacted in 2017. The amendment focused on Chapter III, 'Claims', one of the five Chapters of the Civil Code that provides the rules of the contract law. Because this Chapter has not undergone any significant changes in the past 120 years, it is expected that this historical amendment will significantly affect the contract practice. While a substantial part of the amendment clarifies the rules through the revision of the language and incorporation of the rules established by court precedents and prevailing interpretations of legal issues directly into the articles, there are a number of rules that underwent significant change to improve the contract law. The two material rules that underwent significant revision and are expected to have a substantial effect on real estate transaction practice are summarised below.

Warranty against hidden defects and liability for non-conformance with the contract terms in connection with the type, quality and number/amount of the subject of sale

a The amended Civil Code changed the term 'defects' in the statutory warranty against hidden defects to 'non-conformance with the contract terms in connection with the type, quality and number/amount of the subject of sale'. After this change comes into effect, the liability of the seller of real estate will, in theory, be determined not by the physical status of the real estate (and other incidental factors), but by both the physical status of the real estate and the intent of the seller and the buyer (without consideration for whether the intent was explicitly expressed in a written contract). The remedies for 'non-conformance with the contract terms in connection with the type, quality and number/amount of the subject of sale' will be granted more in accordance with the general default principles of contract law. If non-conformance with the contract terms is found to exist in connection with the type, quality and number/amount of the subject of sale under the amended Civil Code, the remedies available to the buyer will be to require the seller to complete performance of the contract, request a reduction of the purchase price, recover compensation from the seller in an amount that restores the buyer to the same position as if the non-conformance did not occur (but only where the non-conformance is attributable to the seller), or a combination of any of these remedies. The buyer also has the option to terminate the real estate sale and purchase contract. It is important to note that the remedies available to the buyer set forth above refer specifically to the remedies available under law; both before and after the amendment, the warranty against hidden defects and the liability for non-conformance with the contract terms in connection with the type, quality and number/amount of the subject of sale can be eliminated by an agreement between the parties.

b The legal nature of the liability for warranty against hidden defects was unique in that the warranty was based on a theory that if a seller delivered to the buyer the specified subject of the sale, such as specific real estate, the seller would be considered to have completed its duty of delivery. In other words, no defective performance of the seller would be considered to exist after the delivery. The warranty is therefore provided under the Civil Code as a special protection for the buyer of the specified subject of the sale. Based on this unique theory and the legal nature of the warranty, the seller's liability under the warranty will be an amount equal to the buyer's reliance with respect to the sale and purchase; namely, the buyer can only recover the transaction costs. Termination is a possible remedy for the buyer under the warranty against defects, but only when the hidden defects render the purpose of the sale and purchase unachievable.

c It is possible that, in certain transactions, the seller's completion of delivery of the relevant subject will not be enough for the seller to fulfil its promise, and accordingly, the amended Civil Code has taken the position that in such instance, the seller will be deemed not to have completed performance of its duty in the sale. Therefore, the amended Civil Code imposes a duty on the seller to complete performance of the defective part if non-conformance with contract terms is found to exist in connection with the type, quality and number/amount of the subject of sale. In the case of non-conformance, the buyer will be able to recover compensation in an amount that restores the buyer to the same position as if the non-conformance did not occur (but only if the non-conformance is attributable to the seller). The liability of the seller in this case is the same amount imposed in conventional cases of non-performance of a contract, and may include lost profits resulting from the non-conformance. In accordance with conventional cases of non-performance of a contract, the buyer will also be able to request complete performance of the contract, and/or a reduction of the purchase price. The buyer may also terminate the contract except in the case where the relevant issue is minor.

d As the liability set forth in the amended Civil Code is based on a theory that differs from the current Civil Code, it is possible that the liability for non-conformance with the contract terms in connection with the type, quality and number/amount of the subject of sale under the amended Civil Code will differ from the liability resulting from the warranty against hidden defects under the current Civil Code, which may in turn cause confusion in practice. It will therefore be essential that the players in the real estate sale and purchase market sufficiently prepare for the new liability framework.

Requirements to assert the right to invalidate a fraudulent conveyance

a The amended Civil Code provides clarification with respect to the requirements to assert the right to invalidate a fraudulent conveyance. One of the main purposes of the amendment is to amend the requirements so that they conform to those set forth in the bankruptcy and other insolvency statutes. The amended Civil Code will provide guidance with respect to the issue of invalidation of a sale of real estate by a creditor of a seller with poor financial health.

For example, the amended requirements for invalidation of a sale and purchase transaction made with a reasonable sale price generally require that at the time the sale is conducted: (1) there is an imminent risk at the result of the sale that the seller may conceal or take similar actions with respect to the sale proceeds; (2) the seller intends to conceal or take similar actions with respect to the sale proceeds; and (3) the buyer is aware of the seller's intent described in (2). These are the requirements that must be met under the bankruptcy and other insolvency statutes and are generally considered to provide clear guidance in practice. Introduction of these new requirements will provide stability to the transactional practice in the real estate sale and purchase market.

b The amended Civil Code also includes provisions that improve the framework used to invalidate a fraudulent conveyance. One of these amendments is with respect to the enforcement of a judgment. Specifically, once the court renders a judgment that invalidates a fraudulent conveyance, the judgment will be binding on the seller and all its creditors. This amendment is expected to clarify the legal relationship among all parties involved in a case of a fraudulent conveyance.

c The amended Civil Code is expected to improve the framework used to invalidate a fraudulent conveyance and anticipated to provide clarification with respect to the requirements to be met in order to invalidate a sale of real estate by a seller with poor financial health. In turn, this will effectively provide players in the real estate market with more stability in real estate sale and purchase transactions.

VIII OUTLOOK AND CONCLUSIONS

For the past few years, Japanese real estate transactions have maintained a steady volume that is historically high. There have been continuous efforts by the Japanese government to encourage real estate transactions, such as the efforts to create new investment structures using the GK-TK structure that are discussed in Section VII, above. We also see a new emerging business related to real estate (i.e., Home-Sharing Services) for which the government is establishing a regulatory framework (as discussed in Section VII, above). While, in the short term, this new type of business may compete with the traditional hotels (one of the major real estate sectors), in the longer term this is potentially a new frontier even for traditional real estate market players. We expect that the Japanese real estate market will continue to evolve as the government continues its efforts to provide a 'user-friendly' legal framework, such as the recently enacted historical amendment law for the Civil Code (as discussed in Section VII, above). In addition to noting the high volume of real estate transactions in Japan, attention should also be paid to the dynamism seen in various aspects of the Japanese real estate market as we prepare for new trends.

Chapter 20

MEXICO

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I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

Mexico is organised as a federation formed by 31 states and a federal district. Original ownership of land within Mexican territory belongs to the nation, with all private ownership deriving therefrom.

In general terms, ownership of the following is reserved to the nation: (1) coastal waters and interior waters that are connected thereto, including rivers, lakes and the land underneath, as well as all underground water, (2) listed mineral deposits that may be industrially exploited, and (3) liquid, solid and gas hydrocarbon deposits.

Based on the foregoing, private parties may own land and constructions, but not (1) rivers or lakes (nor the land areas covered by them) connected to federal waters, and (2) listed natural mineral deposits, nor hydrocarbons. This is an important distinction between Mexico and other countries, as the existence of exploitable mineral or hydrocarbon deposits may impose important restrictions on private property rights, which may result in an expropriation or temporary occupation.

In addition to the foregoing, under Mexican law there exist agrarian community ownership regimes: *ejidos* and *comunidades*. Save for minor differences in their organisation, *ejidos* and *comunidades* are equivalent regimes that basically provide for ownership of land by an agrarian community under a special regime different and distinct from private property (*ejidos* and, attributively, *ejido*). Of interest to private parties is the fact that *ejidos* cover a substantial portion of the Mexican territory, that *ejido* land may become private land under certain circumstances, and that private parties may enter into agreements to use *ejido* land subject to certain requirements and conditions, all as regulated by the Agrarian Law.

ii System of registration

Private property is governed by the civil code of each state, with each state and the federal district having its own public property registry system, with offices in different locations within the state (the Public Registry). The majority of the states' civil codes, and that of the federal district, establish that the purpose of this recordation of real estate transactions is to publish them, and not to create a registry that is constitutive of rights.

This means that a purchase and sale contract, for example, will be valid and enforceable between the parties executing the same, but has to be recorded to give it full effect before third

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parties. If a purchase and sale transaction is entered into but not recorded, a later purchase and sale transaction over the same property that is recorded would have preference over the first transaction.

Most states allow for notary publics to file a preventive notice with the Public Registry before a real estate contract is executed, to freeze recordings on the property for a certain period, allowing the parties to enter into the corresponding agreement before the notary and have it filed for recordation before such a period ends, eliminating the risk of another recordation being made in the interim between execution and recordation.

The creation of *ejidos* are recorded in the National Agrarian Registry, which is a federal agency with offices throughout the country. When a property ceases to be *ejido* land through the corresponding procedure established in the Agrarian Law, title to the same is recorded in the Public Registry and is cancelled in the National Agrarian Registry.

In addition to the foregoing, note must be taken of the existence of the Federal Property Public Registry, which relates to properties owned by the federal government and by federal agencies, and is regulated by the General Law of National Properties, which establishes that in the event of a discrepancy between a Public Registry recording and a Federal Property Public Registry recording, the second shall prevail.

Note also that there is no specific guaranty from the Public Registry or from the notary against damages for legal defects in title deeds or registrations. Although a registrar or a notary may incur personal civil liability for negligence, successful lawsuits to recover damages from them are unheard of in practice. Considering this, and although, as with any insurance, there are exclusions and exceptions, title insurance should be considered as an option to reduce the risk of economic loss due to title defects; title insurance has been available in Mexico for around 15 years.

iii Choice of law

Civil codes do allow the parties to a contract to agree on a foreign law to govern the contract, but foreign laws will not be applied in the case of provisions contradicting public order provisions of local laws.

By constitutional mandate, real estate properties (and thus real rights) are governed by the law of the state in which the property is found. This principle can be considered as one of 'public order' and therefore any choice of law provision relating to real property or rights would not be valid.

Considering the foregoing, it is not recommended to agree on substantive laws different from those in effect in the state where a property is found to govern a real estate contract.

II OVERVIEW OF REAL ESTATE ACTIVITY

Mexico has seen tremendous movement in the real estate market in the past three decades. The opening of the country to foreign investment in the early 1990s brought direct investment both from large international manufacturing companies and from investment funds.

Notwithstanding the fact that, with the advent of democracy, there have been changes in power at the federal government level, the country's economic model has not changed and foreign investment continues to be an important component of the same.

Even through different worldwide crisis periods in recent times, foreign investment has continued to arrive in different parts of the country, creating demand for industrial properties, office buildings and infrastructure.

Mexico has a strong financial system, with loans available from institutional banks. There is also a substantial presence of capital in the market from private equity funds (both local and foreign).

Another source of financing for infrastructure development have been equity development certificates (CKDs), a product that has allowed investment to flow from the Mexican retirement fund managing system, through the Mexican stock exchange (BMV). Currently there are over 70 CKD issuers listed with the BMV.[2]

Additionally, Mexican tax laws have been revised in recent years to create incentives for real estate development, the most important of which is the creation of real estate investment trusts (FIBRAs). Today there are 12 FIBRAs listed with the BMV.[3]

Finally, recent new laws opening the energy sector to private investment (both foreign and local) will have an effect on the real estate market in the long run, as a natural consequence of private investment flowing to this sector.

III FOREIGN INVESTMENT

Foreigners may not under any circumstance acquire directly title to real estate properties located within 100km of Mexican borders or within 50km of its coastal beaches (the Restricted Zone).

To directly acquire properties within Mexican territory but outside the Restricted Zone, foreigners need a permit from the Ministry of Foreign Affairs, and also need to agree to be considered as nationals with respect to the property being acquired and not to invoke the protection of their governments in connection therewith, under penalty of losing the property to the Mexican nation if they breach the agreement. Mexican companies with foreign investment are also required to conclude such an agreement, and may not acquire residential properties in the Restricted Zone.

The Foreign Investment Law provides that the Ministry of Foreign Affairs may issue and publish general rules exempting foreigners from obtaining a permit, with conclusion of the aforementioned agreement being sufficient for the acquisition of a property outside the Restricted Zone. Currently, there is a rule so issued and published exempting nationals from countries with which Mexico has diplomatic relations from obtaining such a permit.

Foreigners may acquire personal (as opposed to real) rights to use and enjoy properties located within the Restricted Zone through trusts established with Mexican financial institutions, and with prior authorisation from the Ministry of Foreign Affairs.

Additionally, there are restrictions on private ownership of agricultural land by a single individual, to avoid the accumulation of large estates in the hands of few owners. The maximum amount of land that may be owned by a single individual is determined based on the quality of the land for agricultural purposes or for raising cattle. For example, the maximum area of prime agricultural land that may be owned by a single individual is 100 hectares. With respect to legal entities, they may own up to 25 times the maximum amount, but must issue a special series of shares, called 'T' shares, which should be distributed to sufficient individuals such that the maximum allowed per individual is not exceeded. Only shareholders holding series T shares may receive agricultural land upon liquidation of the

2 www.bmv.com.mx/es/emisoras/informacion-de-emisoras.

3 Ibid.

company. Foreign investment in series T shares is restricted to 49 per cent. Companies failing to comply with this restriction may be forced to resolve the situation or sell properties that exceed the limit.

IV STRUCTURING THE INVESTMENT

There are different ways to structure a real estate investment. Most common are:

a private real estate trusts;

b stock corporations, namely the *sociedad anónima*, or SA, and the *sociedad anónima promotora de inversion*, or SAPI;

c limited liability companies (S de RL);

d FIBRAs; and

e contractual arrangements that do not constitute a legal entity nor a trust, including the participation partnership (AP).

Private real estate trusts are contracts under which private parties convey, as settlors, ownership of real estate properties to a trustee (a Mexican financial institution authorised to offer trustee services), with certain objectives for that property (its development and sale or lease, for example), for the benefit of the settlors or of different beneficiaries named by the settlors.

A trust can be structured as a pass-through entity for tax purposes or as a tax entity different from the settlors or beneficiaries. Also, the trust may include a technical committee, which could work like a board of directors of a company.

Benefits of the trust include that (1) it can be a pass-through entity so each settlor or beneficiary has its own tax treatment based on its own situation; (2) title is held by a financial institution, thus protecting it against creditors of the settlors or beneficiaries; (3) the structure can include corporate governance provisions similar to those of a company or corporation; (4) the settlors or beneficiaries may terminate the trust and recover the properties previously conveyed to the same; and (5) for purposes of federal taxes, and in most local jurisdictions, the conveyance of a property to a trust is not considered a taxable event until the settlor irrevocably designates a different person as beneficiary and loses the right to reacquire the property.

Stock corporations, namely the SA and the SAPI, are the most common corporate structures used in Mexico. They are very similar, with the SAPI giving more rights to minority interests (10 per cent interest grants the right to a seat on the board, as opposed to 20 per cent in an SA, for example) and also having the flexibility of the company being able to repurchase its own shares. They are legal entities, different and distinct from their shareholders for legal and tax purposes.

The stock corporation grants to the shareholders the benefit of limited liability in most circumstances, and the option to establish institutional corporate governance provisions and special rules on transfers of shares (drag-alongs, tag-alongs, rights of first refusal, etc).

The S de RL is the second most common corporate structure. It does not issue stock. It grants limited liability to its partners and is a different and distinct entity for legal and tax purposes. It is used mainly by US investors, as current check-the-box elections allow for its treatment by US shareholders as a corporation or a pass-through entity.

FIBRAs are real estate investment trusts with certain tax benefits, created to promote real estate developments for lease. Benefits include, among others, the following: (1) FIBRAs are exempted from income tax provisional payments; (2) foreign pension and retirement funds have an exemption from paying income taxes deriving from the certificates and from capital gains upon their sale; and (3) Mexican individuals and non-resident foreign persons have an exemption from income tax on capital gains of publicly traded certificates issued by the FIBRAs.

Other contractual arrangements that do not create a trust or a legal entity are used in the market, although not so much for institutional investments. One of them is the AP, which is regulated by the General Law of Business Organisations and under which one partner contributes resources and the other partner develops the project in a fronting arrangement and in relation to third parties. The AP was widely used in the past but is no longer an option for many investors or developers as current tax laws consider it to be a tax entity, distinct from its partners.

V REAL ESTATE OWNERSHIP

i Planning

Mexico has three levels of government: federal, state and municipal.

As regards use of land, three removal and construction permits are issued at the municipal level, but environmental impact authorisations are required at the state and, in some cases, at the federal level.

Municipal plans dictate zoning, but forest lands require a change-of-use permit issued at the federal level by the Ministry of the Environment and Natural Resources (SEMARNAT). Sometimes a developer may have the municipal permit but still require the federal forest-land change-of-use permit, which involves impact and justification studies.

Changes of use of land that require a deviation from approved zoning plans require a meeting of the municipal council to approve the change at the zoning-plan level. Timing can be an issue as approval is not issued by a single officer of the municipality, but by its council.

In some jurisdictions, coordination by the three levels of government may not be optimal, therefore a careful study by expert consultants of permits required at each level of government for a development is a must.

ii Environment

Landowners and parties in possession of land are jointly liable for remediation in the event of contamination. This calls for careful structuring of real estate transactions, so that a party acquiring a property or rights to use the same does not assume liability for contamination of a site by taking possession before it is strictly necessary. For example, if a lease is entered into subject to certain conditions (such as satisfactory due diligence), the agreement should establish clearly that the tenant will not take possession of the site until all conditions are satisfied.

Additionally, a site contaminated with dangerous residues may not be conveyed without approval from SEMARNAT.

iii Tax

Federal taxes that may be caused by the sale of real estate include income tax and value added tax. Value added tax (currently 16 per cent) is applicable only on the conveyance of improvements, not land. There are certain exemptions in the case of sales of residential properties.

In addition to federal taxes, the acquisition or transfer of property also produces a local tax. The rate of this tax may vary from state to state, but most charge a rate of 2 per cent on whichever of the officially appraised value and the purchase price is the higher.

In most jurisdictions, the notary public before whom a purchase deed is signed cannot fully approve the deed for recordation until the real estate transfer tax is paid. Payment of this tax within the effective term of the preventive notice is of upmost importance, therefore, otherwise the deed cannot be filed for recordation with the Public Registry.

Finally, as the transfer or acquisition tax is regulated by each state, there may be transactions that in one jurisdiction produce the tax yet in others do not. For this reason, each transaction has to be analysed on the basis of the location of the property.

iv Finance and security

Security over real estate is granted either through mortgages or through guaranty trusts.

In both cases it is very important to have the security recorded in the Public Registry for it to be effective against third parties.

Special note must be taken about mortgages securing future obligations, as a filing with the Public Registry is required by most state civil codes each time a secured future obligation is created. In this scenario, a guaranty trust may be more practical as no additional filings would be required once the trust is established and recorded.

As guaranty trusts have become widely used, trustee fees are lower than before and in certain cases this option may be preferable to the mortgage.

VI LEASES OF BUSINESS PREMISES

Leases create personal (as opposed to real) rights to use real estate properties in Mexico for a determined consideration. Lease terms have different maximum limits depending on the state in which the property is found.

Civil codes are generally protective of tenants. With variations depending on the state, landlords' obligations include (1) guaranteeing the property is fit for the intended purpose; (2) non-disturbance of the tenant's use of the leased property; (3) guaranteeing quiet use and possession; (4) making all repairs necessary to maintain the property during the term (except for minor repairs that are to be performed by the tenant); and (5) indemnifying the tenant for hidden defects.

In general tenants are presumed liable for fire affecting the leased property, and thus are usually contractually required to maintain property damage insurance.

Rent increases are usually indexed by contract to the consumer price index (CPI). In some cases rent is set in US dollars and indexed to the US CPI; note that in such cases, pursuant to the Monetary Law of the United Mexican States, any payment obligations established in a foreign currency to be paid in Mexico can be fulfilled by paying Mexican currency at the applicable exchange rate on the date of payment, as determined by the Bank of Mexico, the Mexican central bank.

It is very common in Mexican leases to include a solvent individual or entity related to the tenant as surety for payment of rent in the event that the tenant fails to do so. Such a guaranty can be structured as a 'joint and several liability' or as a personal civil guaranty. In the case of a personal civil guaranty, the tenant would have to be sued and its assets attached before going after the guarantor, unless the guarantor expressly waives the corresponding civil code provisions. When there is no satisfactory guarantor surety, bonds issued by authorised surety bond institutions are also a common option.

The market has evolved because of foreign investment, and lease contracts can be as complex and sophisticated as leases in the United States and some European countries, with triple net leases, build-to-suit leases, ground leases with tenant construction rights, etc.

Note should be taken that although many provisions with origins in other jurisdictions may be validly agreed upon in the lease contract, waivers to civil code provisions have to be included expressly in the document.

Nonetheless, there are provisions that are not valid in Mexican leases, and certain civil code provisions cannot be waived; for example: (1) provisions relating to recovery of possession by the landlord without a trial are not valid; (2) a waiver to termination rights because of the impossibility of using the property for a certain period as a result of a force majeure event is not valid; and (3) provisions waiving maximum length of lease terms established in the civil code are not valid.

Most state civil codes establish a right of first refusal in favour of the tenant in the event of the sale of a property if the tenant has been leasing the property for a certain period and if it has made improvements to the same.

In general, state civil codes establish that when a leased property is sold or otherwise transferred by the landlord, the lease remains in place and the new owner becomes the landlord.

It is important to consider local registration requirements in most states for leases to be effective in respect of third parties when they exceed a certain duration, or when more than a certain number of monthly rents have been prepaid.

It is also important to consider that in some states having a lease ratified or granted before a notary public may allow for a faster procedure to evict a defaulting tenant, so it is worthwhile for a landlord to consider the small expense of observing such a formality.

In particular in the case of ground leases, where the tenant will make an important investment in construction, the tenant may consider title insurance to cover its leasehold interest.

VII DEVELOPMENTS IN PRACTICE

i FIBRAs

Mexico incorporated into its legislation a tax incentive so that, through trusts with a specific purpose, all types of investors, including private parties, pension funds and foreign persons, would invest in real estate properties destined for lease. We can currently say that the legislation has been successful.

A FIBRA is a trust that may be privately or publicly held, in which 70 per cent of the assets should be real estate properties, and whose main purpose has to be: (1) the acquisition of real estate properties for lease to third parties; (2) the acquisition of lease collection rights; or (3) the financing of the foregoing activities.

The general legal framework for FIBRAs is the same as other trusts, but is subject to specific regulation for the protection of investors and with respect to the tax treatment of real property contributions and the returns and other economic benefits they grant. The following are some particularities that stand out:

a the bank acting as trustee issues certificates to each investor that represent an undivided interest in the properties contributed to the trust, the return generated by them and the price received in the event of a sale;

b the trustee bank must calculate the tax result and withhold 30 per cent of the income tax corresponding to the income of the FIBRA (with the exception explained at (d)) and distribute each year at least 95 per cent of the result obtained;

c whoever contributes a property to the FIBRA can defer the income tax deriving from such a conveyance until the trustee sells the same or the investor conveys the certificates received for its contribution;

d pension and investment funds referred to in Article 153 of the Income Tax Law are exempt;

e income tax withholding by the trustee is considered a provisional payment for Mexican tax residents and definitive payment for foreign tax residents (subject to a lower withholding rate under certain international treaties to which Mexico is a party); and

f the sale of certificates through the stock exchange is exempt from income tax for individuals residing in Mexico and for foreigners.

In conclusion, the FIBRA is an interesting instrument that combines fixed and variable rent components.

ii Superficies rights

In recent years, several states have incorporated into their civil code the concept of *superficies* rights. This differs from a lease as a leasehold interest is considered a personal right, whereas the *superficies* right is considered a real right.

Depending on the state there may be maximum terms applicable to the *superficies* right.

This right can be granted over land surface area or over construction surface area, entitling the *superficies* rights holder to make and own improvements thereon.

There are statutes of limitations after which the right is lost if it is not used; that is, the right can be lost if improvements are not made.

This concept gives more flexibility for land development as, for example, in the state of Nuevo León, there is no subdivision process required to grant superficies rights over a portion of a parcel of land.

The parties are free to agree on whether there should be compensation to the *superficies* rights holder at the end of the term, deriving from the improvements made by it.

iii Occupation rights in energy projects

At the end of 2014 new energy laws opening the energy industry to private investment were finally passed.

One very important aspect of any energy project is real estate, from the land needed for extraction activities or for the generation of energy to the land needed for the installation of pipelines, cables and other essential energy infrastructure.

Occupation of land by private parties for energy projects was not specifically regulated in the past as participation in the energy sector was very limited. Private parties' participation in the industry was largely in electric energy, as permits for generation for self-consumption have been available for years.

With the enactment of the new energy laws, the occupation of land has been regulated. Main concepts to consider are:

a the energy company has to provide the landowner with a written explanation of its interest in using or occupying the landowner's land or a portion thereof;
b the energy company must provide and describe the project and address any questions and inquiries from the landowner, so that the landowner understands all implications;
c the Energy Ministry may require the participation of community witnesses;
d the energy company has to notify the Ministry of Agrarian, Territorial and Urban Development of the initiation of negotiations with landowners or parties in possession of the land;
e the legal structure of the occupation (purchase, easement, lease, etc.) must be adequate for the development of the project;
f compensation has to be proportional; it should be made considering market value and cover (1) payment for affected goods or rights other than real estate, and (2) payment for occupation rights, easement or use of land;
g the amount of compensation and terms and conditions of occupation have to be established in writing subject to guidelines and forms issued by the Ministry of Agrarian, Territorial and Urban Development in coordination with the Energy Ministry;
h the agreement has to include dispute resolution mechanisms;
i agrarian property occupation is subject to additional specific requirements;
j particular requirements are to be met in connection with appraisals; and
k agreements have to be filed with a competent court for validation.

This is a general list of items that must be addressed; there are further particularities in the corresponding legal provisions.

Even though requirements may look burdensome, if complied with, the level of legal certainty for the energy company would be very high considering the final agreement would be validated by the judicial system.

VIII OUTLOOK AND CONCLUSIONS

Mexico's openness to foreign investment, including the newly approved energy laws, and the growing economy, make it easy to predict a very active real estate market for the foreseeable future.

As our country continues to develop and to attract foreign investment, our real estate market keeps growing and becoming more sophisticated.

The application of municipal, state and federal laws to different aspects of a real estate project calls for careful due diligence and project planning.

Our registration system, complemented by the availability of title insurance, provides a very good degree of certainty to both local and foreign real estate investors.

Considering the foregoing, together with the country's sound banking system, the availability of, and thirst for, investment by private equity funds, instruments that permit participation in the sector by the Mexican pension fund system, and incentives for private parties and foreign pension funds to invest in real estate, the financial foundations for the future growth of the real estate industry in Mexico seem very strong and we expect to see our industry continue to grow steadily.

Chapter 21

MONTENEGRO

Mihajlo Matković and Tamara Samardžija[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

Under Montenegrin law, any domestic individual or legal person may acquire ownership right over real estate such as residential and business buildings, including apartments, business premises, garages, parking places, a unit forming a separate part of a basement, a unit forming a separate part of an attic (within the building), land plots and other real estate except for natural resources that are in state ownership. In addition, the law prescribes that some resources in general use, such as state-owned construction land, forests and forest land, may be subject to limited ownership rights defined by law.

Pursuant to the Montenegrin Property Relations Act, ownership is the highest title a person or a legal entity can hold over real estate. Montenegrin legislation regulates the following types of ownership over real estate properties:

a exclusive ownership – the highest level of ownership as this type of ownership is only limited by the statutory limitations (i.e., by-laws);

b co-ownership over real estate – ownership by two or more persons over undivided real estate where each owner's share is determined or a fixed proportion (the owners may have the right to jointly manage the use of the property). Each of the co-owners is entitled to freely dispose of its share; however, other co-owners have a statutory pre-emption right;

c joint ownership – ownership over undivided real estate where the shares of joint owners could be but are not determined or fixed; and

d condominium ownership (ownership over a single real estate unit) – according to Montenegrin law, a single apartment, business premises, garage, parking lot, a unit forming a separate part of a basement, a unit forming a separate part of an attic and other single real estate unit (within the building) may be the subject of an exclusive ownership right and, therefore, each of these single real estate units is registered in the land registry separately. Notwithstanding the exclusive nature of such an ownership right, each owner of a single real estate unit is at the same time a joint owner of the common parts and areas. The owners may freely dispose of their ownership over single units together with their corresponding shares of the common parts and areas.

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ii System of registration

In Montenegro, the title over real estate is acquired once the following two conditions are met: *justus titulus* – legal entitlement to the property; and *modus aquirendi* – the registration of the property with the land registry. Hence, the title over real estate is not acquired by the real estate conveyance instrument, but rather by the registration of property ownership in the competent land registry, which has constitutive effect. Proper registration is generally taken as *prima facie* evidence of ownership over real estate.

To acquire title to property, it is necessary that the property that is the subject matter of the acquisition is itself registered in the relevant land registry. For buildings for which occupancy permits have been issued, it may be assumed that the most important prerequisite for the registration of such property in the land registry has been met. The holder of an occupancy permit is deemed to be the initial owner of the property. It is customary to rely on the existence of occupancy permits for the purpose of acquiring property. However, none of the permits may replace the excerpt from the land registry, which remains the only exhaustive proof of title to real estate.

Once the requirements for the registration of property (and its initial owner) in the land registry are met, subsequent buyers are registered on the basis of the real estate conveyance instrument and supplemental documents (i.e., proof of full payment of the purchase price (as applicable) and an authorisation by the transferor for the registration of the transferee as the property's owner in the land registry (*clausula intabulandi*)).

iii Choice of law

Pursuant to the Montenegrin International Private Law Act, all rights *in rem* with respect to real estate and transactions (i.e., agreements related to real estate property) located in Montenegro have to be governed exclusively by Montenegrin law and parties to the contract are not allowed to agree otherwise save for the lease agreement having as subject matter a temporary private use of the real estate for a period up to six consecutive months that shall be governed the law of the state where the landlord has his or her habitual residence, provided that the tenant is a natural person and his or her habitual residence is in the same state.

II OVERVIEW OF REAL ESTATE ACTIVITY

Fostered by rising tourism investments and visitor numbers, property demand in Montenegro has been rising over the past few years. The World Tourism Council has predicted Montenegro will be the fastest-growing tourism destination for the next decade.

At present there are several big construction projects that may further boost the Montenegrin real estate sector, including the following:

a the Bar-Boljare highway project, a key infrastructure highway project led by the Ministry of Transportation and Maritime Affairs awarded to the construction company China Road and Bridge Corporation (CRBC);

b investment in luxury yacht, hotel and residential complex Porto Montenegro has almost reached €450 million. Porto Montenegro is one of the fastest-selling real-estate developments in the Mediterranean, whose properties are expanding and are still under development;

c the Luštica Bay resort, a €1.1 billion luxury development and huge 680-hectare project, 90 per cent-owned by Orascom Development Holding and 10 per cent by the government of Montenegro, includes 1,000 apartments and more than 500 villas and townhouses, seven hotels and a marina, plus a golf course, shops and restaurants;
d the construction of a 72MW wind farm in Montenegro, located at Krnovo, near the town of Nikšić. This is the first commercial wind farm to be constructed in Montenegro;
e works on Portonovi, a luxury resort located in Kumbor and developed by Azmont, will consist of high-end residences, the One&One hotel, Henri Chenot's wellness centre and two marinas, among others. Completion is announced for 2018;
f Porto Skadar Lake is an ongoing mixed-use project located in Skadar Lake. It will consist of 30 private villas, restaurant, hotel, marina, tennis courts and an eco-spa;
g Dukley Gardens, a project developed by Stratex Group and located in Zavala peninsula, consists of 36 villas and 202 houses; and
h renovation of the Maestral Hotel located near Sveti Stefan. Company Monte Rock invested approximately €50 million to purchase and refurbish the hotel. The refurbished Maestral hotel was opened in July 2017 and is now a five-star hotel with 185 rooms, 22 apartments, luxury wellness and spa centre, etc.

III FOREIGN INVESTMENT

Pursuant to Montenegrin law, foreign individuals and legal entities are also allowed to acquire title over real estate; however, there are certain limitations provided by the law.

Foreign natural persons and legal entities cannot acquire: (1) natural resources, (2) public goods, (3) agricultural land, (4) forest and forest land, (5) cultural monuments of special importance, (6) immovable property in land-border areas to a depth of one kilometre and islands, and (7) immovable property located in the area that is designated as non-acquirable by foreign individuals and legal entities on defence and security grounds. In practice, this means that foreign entrepreneurs and foreign legal persons need to either establish or acquire a Montenegrin legal entity to overcome these limitations. An exception to this is that foreign persons (both individual and legal) may acquire the right of ownership over agricultural land, forests and forest land with a total surface area of up to 5,000 square metres, but only if the subject matter of the contract on alienation (purchase and sale, gift, exchange, etc.) is a residential building located on that land.

Foreign individuals may be entitled to long-term lease, concession, build–operate–transfer and other private–public partnership arrangements in relation to the immovable property mentioned in points (1) to (6) above as if they were Montenegrin citizens.

On the other hand, the government of Montenegro has introduced several customs and fiscal incentive measures to motivate foreign direct investment, including the following:

a the amount of tax can be reduced up to 25 per cent of the amount invested in shares and bonds for the fiscal period concerned; and
b legal entities newly established in a municipality and that are active in the field of production can be exempted from tax on profits during their first three years of activity.

IV STRUCTURING THE INVESTMENT

Typically, investment structures on the Montenegrin real estate market (most commonly, in construction business) entail either establishing a special purpose vehicle (SPV) project company that acts as an investor and holds title over the real property; or transactions where an existing company purchases either the real property or the company owning the real property.

The structure using an SPV is preferred by financiers as it allows them full control over the project (e.g., by controlling bank accounts, priority of collateral, and business operations). In these structures the sponsors' equity usually comes in more transparently and with fewer transaction costs (share capital increase may be preferential tax-wise as it is principally tax neutral).

In 'classical' sale and purchase transactions, financing may be diverse – it ranges from intercompany, external, or syndicated loans and equity contributions to mechanisms that are more complex, such as forward purchase and escrow agreements. Collateral includes mortgages, share pledges, bank guarantees and promissory notes.

V REAL ESTATE OWNERSHIP

i Planning

Montenegrin law on spatial development and construction of structures stipulates conditions for spatial development in Montenegro. Planning documents shall lay down the organisation, use and intended use of space, as well as measures and guidelines for development, protection and improvement of space. Planning documents are designated as state and local planning documents.

Funds for the development of planning documents shall be provided from the Montenegro state budget or from local government budgets.

Funds for the development of detailed spatial plans, location studies at state level, detailed urban development plans, urban development designs and location studies at local level may also be provided by interested users of a space.

Regarding change of use for existing structures whose location or other features do not match the conditions stated in the planning document, reconstruction may be approved within the current footprint, which is necessary for maintenance and use of the structure in accordance with its purpose, until the use conformance of such a location is in line with the corresponding planning document.

ii Environment

The responsibility for environment pollution in Montenegro is imposed on the polluter based on two main principles:

a the principle of responsibility of the polluter and the polluter's legal successor: this principle provides that the polluter, be it a natural person or a legal entity causing environmental pollution is responsible under the law, and the polluter or the polluter's legal successor is obliged to address the cause of pollution and the effects of direct and indirect pollution. Changes in ownership of a company or any other legal person must include an assessment of the state of the environment and the determination of liability for environmental damage, as well as an agreement on the liability of the previous owner for the pollution or environmental damage; and

b the 'polluter pays' principle: according to this principle the polluter is liable to pay compensation for pollution if its activities cause or may cause environmental pollution.

The polluter is obliged to cover the total costs of measures implemented to prevent and reduce pollution, which includes the costs of environmental impact assessment and the cost of remedying environmental damage that has occurred.

Along with these basic principles regulating the responsibility of legal entities for environmental protection and courses of action in the case of environmental pollution, the Montenegrin legislature has focused on rules regulating development of real estate (i.e., plants, factories) intended for activities that have or could have an impact on the environment. There are special conditions and procedures for obtaining an 'integrated permit', which is necessary for commencement of construction works, as well as for the use for which these structures are intended. The permit process consists of the following steps:

a submission of an application to the competent authority for the issue of the permit along with all necessary documentation;

b providing notice of the application to the authorities and organisations in the fields of agriculture, water, forestry, planning, construction, transport, energy, mining, protection of cultural heritage, environmental protection and others, local government bodies in the territory of the planned activity, and concerned members of the public;

c establishment of a technical committee (competent for the analysis of environmental impact assessments, application of the best available techniques, and expected local and wider impacts of the intended development on the environment, etc.) by the competent authority; and

d deciding on the application.

On any acquisition it is advisable to engage environmental consultants to examine documentary information and to carry out a site visit. If considered necessary, further, intrusive investigations may then be undertaken. It is important to identify potential problems early, so that there can be negotiation on the terms or price.

iii Tax

Transfer of real estate is, as a rule, subjected to real estate transfer tax (RETT) at a 3 per cent rate, which is payable by the buyer of the property. The tax base is the sale price of the property, but the Tax Administration may adjust the tax base if the sale price is below estimated market value. The tax liability is triggered by entry into a real estate transfer agreement (e.g., sale or purchase agreement) or by the buyer starting to use the property. The buyer must file a tax return and pay RETT within 15 days from such a taxable moment.

Transfers of real estate may also be subject to inheritance tax or gift tax at the same 3 per cent rate. Both taxes are payable by the recipient of the real estate. The tax-return filing and payment deadlines applicable to RETT also apply to these two taxes.

As of 1 January 2018, transfers of newly built real estate are subject to VAT at a 21 per cent rate. Transfers subject to VAT are exempt from RETT and vice versa.

Transfers of a business as a going concern are VAT exempt if the transferee is or becomes a VAT taxpayer and continues to perform the transferor's business activity.

iv Finance and security

The most common form of security granted over real estate in Montenegro is a mortgage. Pursuant to the Montenegrin Property Relations Act a mortgage may be established both over existing real estate (i.e., land, a building or a single real estate unit, as listed under

Section I.i, regarding condominium ownership) and over real estate under construction (i.e., construction permit). In addition, a mortgage may be established over a co-ownership stake in real estate. A mortgage is deemed perfected once it is registered with the land registry – the same registration rules apply *mutatis mutandis* as apply to the registration of ownership over real estate described in Section I.ii, *supra*. Mortgages may, under Montenegrin law, principally be enforced in two different ways (i.e., by way of court – judicial enforcement – or private foreclosure via private or judicial sale).

In addition, share pledges, pledges over bank accounts, bills of exchange and bank guarantees are commonly used to secure project financing in Montenegro.

VI LEASES OF BUSINESS PREMISES

The Montenegrin Law on Contracts and Torts differentiates between leases of residential and of business premises. Namely, the Law contains general provisions that are applied to all types of leases, but also provisions that are specific for each type.

However, lease agreements where the landlord is a public authority (e.g., state, municipality or public entity) may be subject to additional requirements when it comes to their execution, because these cases are further regulated by the Law on State Assets. Yet, even in such cases, the rights and obligations of the parties are governed by the Law on Contracts and Torts.

The main characteristics of a typical commercial lease are presented below.

i Required form

Lease agreements have to be concluded in writing and notarised before a competent notary.

ii Length of term

The Law on Contracts and Torts provides that a lease agreement may be concluded for either a fixed or an indefinite term. A commercial lease agreement concluded for an indefinite period cannot be terminated within the first six months, unless agreed otherwise.

Lease agreements concluded for a fixed term are considered to be converted into a lease for an indefinite term if the tenant continues to use the leased premises after the expiry of the initially agreed fixed term. However, security provided by third parties ceases to be effective once the initial (fixed) period expires.

iii Rent increases

Lease agreements commonly provide for indexation of the rent.

iv Service charge

Under the Law on Contracts and Torts, a tenant is obliged to cover the costs of common services and equipment in the building where the premises are located. Unless otherwise agreed, the service charge is not included in the rent. Also, a tenant is obliged to cover costs of regular maintenance (e.g., cleaning, painting, minor installations, repairs). In practice, costs covered by a service charge and the manner of its payments are regulated in detail in commercial lease agreements.

v Tenant's right to sell or sublease

Under the Law on Contracts and Torts, subleasing of commercial premises is not allowed, unless agreed otherwise.

The Law on Contracts and Torts does not regulate the issue of transfer of lease by the tenant. However, in practice, landlords prohibit such transfers.

vi Insurance

The Law on Contracts and Torts does not regulate this issue. However, in practice, the cost of property insurance for the building is included in the service charge and thus reimbursed to the landlord by the tenant. Also, the tenant is usually required, on its own account and in its own name, to take out, for example, insurance covering contents and liabilities, including the furniture and goods located inside the leased area, employers' liability insurance, and civil and third-party liability insurance.

vii Change of control of the tenant

This issue is not regulated by the Law on Contracts and Torts. Also, this issue is not regularly regulated by lease agreements. In general, lease agreements may envisage that the tenant will be obliged to notify the landlord in the event of change of control of the tenant.

viii Transfer of lease as a result of a corporate restructuring (e.g., merger)

Lease agreements usually envisage that rights and obligations of the landlord under the lease agreement can be assumed by its legal successors or assignees, as notified to the tenant, and the tenant undertakes, upon request of the landlord, to sign the assignment and assumption agreement. Also, it is usual that the tenant waives its right to terminate the lease agreement in the event of transfer of the title over the leased premises.

ix Repair

The landlord is obliged to maintain the premises in proper condition and to perform any necessary repairs. On the other hand, the tenant is obliged to inform the landlord of the necessity of repairs as soon as it arises. If the landlord does not perform the required repairs within a certain reasonable deadline set by the tenant, the tenant is allowed to organise repair by itself or to terminate the agreement. If the tenant performs the repairs without notifying the landlord, it is obliged to compensate the landlord for damage suffered. If the repairs hinder use of the premises for a certain period, the tenant is entitled to a proportionate decrease of the rent. If the premises cannot be used at all because of repairs, the tenant is not required to pay rent for the relevant period.

The costs of smaller repairs caused by regular use of the premises, and the costs of the use itself, are borne by the tenant.

VII DEVELOPMENTS IN PRACTICE

i Consolidating procedures for construction permits

Montenegro made dealing with construction permits easier by introducing a one-stop shop and imposing strict time limits for the issuance of approvals. On a related note, dealing with construction permits has become more simplified by reducing the time needed to issue building permits, implementing amendments to the Law on Spatial Planning and Construction, which established a 30-day time limit for issuing building permits. Furthermore, the whole relevant procedure has become substantially less costly by reducing the fee for the provision of utilities on construction land and eliminating the fee for obtaining urban development and technical requirements from the municipality.

ii Shortening the property transaction registration time (practice)

According to the World Bank World Development Report, Montenegro improved average property transaction registration time from 25 days in 2009 to the current eight days. On a related note, the procedure for registering property has been made considerably easier by the introduction of a notary system.

iii Improvement of planning and construction regulations

Recently Montenegro made a significant improvement to planning and construction regulations, completing four rule books and implementing an extensive training programme for staff at the national and municipal levels, with over 2,300 people trained.

iv Real estate energy efficiency

Potential investors should be aware of the Montenegro Energy Efficiency Act, which stipulates that buildings, depending on their type and purpose, must be designed, built, renovated and maintained in such a manner as to preserve the prescribed energy ratings when in use. The energy rating of a building is the actual or estimated amount of energy consumed to meet the different needs of the building depending on its type and purpose, and it includes heating, hot water, cooling, ventilation and lighting.

v Government foreign investment incentives

The Montenegrin government has recently adopted the Memorandum on Montenegro's Development and the Strategy for Attracting Foreign Direct Investment.

Memorandum on Montenegro's Development

The Memorandum on Montenegro's Development defines the country's strategic priorities and policies for a three-year term, along with concrete measures and public investments that will contribute to the economic and social development of the country. Policies are to be funded from domestic and foreign funds, with particular emphasis on the EU assistance that Montenegro gets through Instrument for Pre-accession Assistance funds. The memorandum specifies Montenegro's strategic priorities of tourism, energy, agriculture and development of rural areas. It also prescribes key measures, projects and funds needed for pursuing such a policy, with the total amount of investment estimated at €1.16 billion.

Strategy for Attracting Foreign Direct Investment

The Montenegrin government adopted the two-year Strategy for Attracting Foreign Direct Investment with the aim of improving Montenegro's image as an investment destination, enhancing competitiveness of the Montenegrin business environment, increasing foreign direct investment and transforming Montenegro into a leading platform for business development in the region. The strategy envisages the creation of 10,000 new jobs directly, while indirectly the desired overall impact is for a total of 32,000 new jobs. Investment will be targeted from rapid-growth markets while encouraging more regional development, whereby it is hoped that at least 20 per cent of investments will be directed to northern Montenegro. Investments are anticipated to total €1.6 billion.

VIII OUTLOOK AND CONCLUSIONS

In recent years, the Montenegrin government has introduced a number of business environment improvements, including a one-stop shop for permits, strict time limits for the issuance of approvals and a decrease in the number of procedures required for obtaining a permit. This has had a particularly beneficial impact on the real estate sector and has led to an upgrade on the EBRD market institutions score for this sector. These reforms enabled Montenegro to maintain relatively good standing in the World Bank Doing Business 2018 report, which places the country at number 42 out of 190 countries for overall ease of doing business, up nine places from a year ago. These efforts represent significant movement towards attracting new investors in the real estate industry.

However, the problem of non-performing loans (NPLs) – one of the key priorities identified for 2017 – was not resolved. Many NPLs in Montenegro are related to real estate, which makes them harder to resolve. A coordinated approach by the government, the central bank and local banks is needed, with a strong emphasis on supervision and enforcement rules.

With regard to Montenegrin GDP growth in 2018, the EBRD predicts it will be 3.3 per cent, considering the rising public debt. Future challenges may include keeping such debt under control.

Chapter 22

NETHERLANDS

Max van Drunen and Leen van der Marel[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, below). 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, below).

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 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 created 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

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takes place, however, once a notarial deed of transfer of title or creation has been signed in implementation of the purchase agreement or other title, and when such a deed has been registered with the Land Registry Office.

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 titleholders and stores the documents on which such entitlements are based. Attachments and restrictions under public law (see also Section V, below) 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 a 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 transfer of real estate located in the Netherlands and the creation of limited rights on it.

II OVERVIEW OF REAL ESTATE ACTIVITY

Investment in the Dutch real estate market has grown substantially in recent years. Volumes for 2012 were €4 billion, for 2013 €5.1 billion, for 2014 €10.1 billion, for 2015 €11.6 billion and for 2016 €13.5 billion.[2] A large transaction in 2016 was Blackstone's sale of a Dutch office portfolio to VIVAT with a deal value of over €500 million.[3] The largest single asset transaction in 2017 was the sale of the office building Atrium, located in Amsterdam's Zuidas business district, by Icon Real Estate to Amundi. The deal value was €500 million.[4]

2 CBRE, *The Netherlands Real Estate Market Outlook* 2017, p. 5–6.

3 Het Financieele Dagblad, 4 October 2016.

4 Het Financieele Dagblad, 11 April 2017.

Because of the low interest rates and confidence in the economy, recent years have shown investor optimism. Real estate is regarded as an attractive investment with stable returns. In 2016, foreign investors had a share of 58 per cent in the total investment volume. Investors from the United States, the United Kingdom and continental Europe had a share of 69 per cent in the foreign investment volume.[5]

Institutional long-term investors appear, primarily, to want to expand in retail and office real estate, especially grade A locations, and residential real estate. Other institutional and non-institutional investors are increasingly often invited to participate in private funds; examples are the ASR Dutch Prime Retail Fund, with a total value of €1.4 billion, and the ASR Dutch Core Residential Fund, with a total value of €0.9 billion.[6] Residential property, along with logistics and hotels, are the asset classes being viewed as a solid investment with acceptable direct returns.

III FOREIGN INVESTMENT

Where entitlement to immovable 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.

American, British and German parties are well represented in the Dutch real estate market. In recent years, the importance of investors from emerging countries has increased.

IV STRUCTURING THE INVESTMENT

A real estate investment, either as a direct or indirect acquisition, can be structured in many different ways. Amendments to law and regulations regularly result in new structures or in variations on existing structures. Obviously, specific investors' legal, financial, organisational and tax planning are also taken into account when structuring the investment.

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. The BV's articles of association may limit or exclude certain shares from sharing in the profits. Certain shares may also be excluded from voting.

The main differences between BVs and NVs are as follows:

5 CBRE Research, *The Netherlands Real Estate Market Outlook* 2017, p. 6.

6 See www.asrreim.com/funds/asr-dutch-prime-retail-fund and www.asrreim.com/funds/asr-dutch-core-residential-fund.

a the shares in an NV are in bearer or registered form; the shares in a BV are in registered form only;
b the minimum authorised, issued and paid-up capital of an NV is €45,000; a BV has no minimum capital; and
c Dutch law offers a lot of flexibility to arrange for a fully tailor-made set of BV articles of association.

The BV and NV are subject to Dutch corporate income tax and distributions are, in principle, subject to Dutch dividend withholding tax. However, the new Dutch coalition government has announced in its coalition agreement of 10 October 2017 that the Dutch dividend withholding tax act will be abolished as per 2020.

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 investors. The general partners act on behalf of the CV, hold legal title to the real estate assets 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 also 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 in the CV 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. A limited partnership is a popular investment vehicle, because it can be established as transparent for Dutch tax purposes. In that case, the CV itself is not subject to corporate income tax and dividend withholding tax in the Netherlands; for tax purposes, all assets and liabilities are attributed directly to the general and limited partners and will be taxed at this level. A non-transparent CV is subject to corporate income tax and dividend withholding tax (at fund level). In short, a CV will be considered transparent for Dutch tax purposes if the accession or replacement of a limited partner requires prior consent of all other limited partners.

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 Dutch tax purposes, an FGR can be established either as transparent or non-transparent. A transparent FGR is not subject to corporate income tax and dividend withholding tax; for tax purposes, all assets and liabilities are attributed directly to the investors and will be taxed at this level. A non-transparent FGR is subject to corporate income tax and dividend withholding tax (at fund level). In short, an FGR will be considered transparent for Dutch tax purposes if units in the FGR are transferable only with the consent of all investors or if units in the FGR are only transferable to the FGR by way of redemption of units (in which case no prior consent of all participants is required).

iv Cooperative (coop)

The coop is an association incorporated by a 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. Until abolition of the Dutch Dividend Withholding Tax Act, scheduled as per 2020, distributions by a coop are in principle subject to Dutch dividend withholding tax. Subject to certain conditions, distributions made by a coop directly investing in real estate could be structured in a way so that they 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 and a non-transparent 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 management board. Further to the abolition of the Dutch Dividend Withholding Tax Act, as from 2020, FBIs will no longer be allowed to directly invest in real estate and these FBIs will as from that moment become subject to the ordinary Dutch corporate income tax regime.

V REAL ESTATE OWNERSHIP

i Planning

An owner's rights to the use of immovable 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 immovable property situated on it. Permits concerning the construction of immovable property can be issued if the intended use is in keeping with the zoning plan. An exemption is the permit for 'spatial planning for contrary use', which provides flexibility to municipalities. Enforcement measures are available in the event of failure to comply with the prescribed use of the zoning plan or the permit for spatial planning for contrary use.

Should a landowner desire to construct immovable property, convert existing immovable property or carry out activities harmful to the environment, a permit is required. On the grounds of the Environmental Permitting (General Provisions) Act, 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, real estate transfer tax (RETT) is in principle levied upon the acquisition of immovable property located in the Netherlands. The same applies to rights to which immovable property is subject, such as leasehold or building rights. The term 'acquisition' includes the acquisition of beneficial ownership. The rate for residential properties is 2 per cent and the rate for other immovable properties is 6 per cent.

The acquisition of shares in a company holding Dutch real estate could also be subject to RETT if each of the following conditions are satisfied (cumulatively):

a the purchaser, together with related entities, acquires or increases a one-third or more interest in the company;

b upon the acquisition or at any time during the preceding year, the assets of the target comprise, determined on the basis of the fair market value (1) for more than 50 per cent foreign or Dutch real estate and (2) for 30 per cent or more Dutch real estate including shares in Dutch real estate companies; and

c the real estate companies are fully or primarily (70 per cent or more) used for real estate trading or exploitation activities.

If applicable, the RETT will be levied on the higher of (1) the value of the real estate assets (i.e., without deducting any debts whatsoever) and (2) the purchase price.

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 RETT applies to the acquisition of newly constructed immovable property or building land in respect of which VAT is due.

The delivery of possession of immovable property is in principle exempt from VAT, unless it concerns the delivery of possession of new immovable property taking place before or within two years after the date of first occupation; or the delivery of possession of building land. In principle, these forms of delivery of possession have a 21 per cent VAT imposed on them.

iv Finance and security

Immovable property may be encumbered with a mortgage. A mortgage is a limited security interest intended to provide recourse against the immovable property for a claim for payment of a sum of money, with preference over other lenders. The financing of immovable property with a mortgage as security interest for the financier is customary with regard to the immovable 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 immovable property, the mortgage right on the immovable 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 immovable 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. As of 1 January 2015, sale under execution of immovable property is possible via the internet. This makes the sale under execution accessible to the wider public and aims 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 even be created prior to the mortgagee 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 immovable 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 immovable property for retail trading, as well as its use as a hotel, restaurant, café or craft workshop. The premises must include a space accessible to the public for the direct supply of movable goods or services. The regime for retail premises is intended to offer protection to the lessee by means of (semi)mandatory provisions because of the location specificity of the lessee's business. The other business premises category is a residual one. This regime covers all built immovable 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 the Real Estate Council of the Netherlands models. These models, including an extensive set of general conditions, 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 indexation, lessee liability, limitation of lessor liability and security aspects.

i Retail premises

General leasing regulations apply to the retail premises category. In addition, (semi)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 with effect on the expiry date of the retail lease 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.[7]

7 This termination ground only applies after an expiration period of at least 10 years.

The aforementioned termination grounds are without prejudice to the right of the lessor to (prematurely) terminate a lease in the event of a default by the lessee, for example, non-payment of rent. Rent in arrears equalling at least three months – and this applies to both types of business premises as well as residential premises – is generally considered to be sufficient to enforce dissolution of the lease, which can only be effectuated through a court order.

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 as from the date of eviction specified in the notice of termination. 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 on 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 DBFMO (design, build, finance, maintain and operate) contract. Recently, PPPs have been structured in a way that better facilitates financing by institutional investors.

ii Networks

According to Dutch law, a network of one or more cables or pipes constitutes individual immovable 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 authority of the stated owner to construct the network. 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 the transfer and encumbrance of the network. Following publication of the registration, an expiry period of one year commences, during 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.

iii Restructuring

As a result of the economic situation in the past, there has been a significant amount of work in the field of restructuring. Foreign investors have shown interest in real estate portfolios with a value below the amount of the raised loans.

iv Energy label

As of 1 January 2015, sellers and lessors of real estate are obliged to provide purchasers and lessees respectively with an energy label (with categories A through G, A being the most energy-efficient). This label shows whether the real estate is energy efficient and which energy-saving measures are possible. Non-compliance with this obligation is subject to a fine. As of 2023, office buildings with an energy label category D and higher may no longer be used.

v Park management

Professional land management in the form of park management is being seen increasingly often in the Netherlands. Because of 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, above) or the 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.

vi Business Improvement Zones Act

On 1 January 2015, the Business Improvement Zones Act entered into force. This Act intends to permanently enable the establishment of business improvement zones (BIZ), following on from the Business Improvement Zones Experiments Act. With this bill, municipalities will be able to designate an area with retail or other business premises as a BIZ. In this BIZ, an area-based levy (BIZ contribution) will be established. This levy will be collected by the municipality, and aims to finance facilities chosen by a majority of entrepreneurs who are obliged to contribute. These facilities will serve both the joint interest of the entrepreneurs and the public interest.

The revenues from the levy will be distributed in the form of a subsidy by the municipality to an association or foundation established by entrepreneurs in the BIZ. This subsidy will pay for activities in the public areas of the BIZ aimed at enhancing living conditions, safety, spatial quality or economic development.

vii Lessor Levy Act

The legislature introduced a levy for lessors who lease more than 50 homes in the controlled rents sector (homes with a net monthly rent up to €710.68 – the applicable amount for 2018).

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 value per home is subject to a maximum of €250,000. The Lessor Levy 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 €2.1 billion in 2018. Lessors can apply for a reduction in 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. Nationally listed buildings are exempted from the levy.

VIII OUTLOOK AND CONCLUSIONS

Dutch law regarding immovable 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 immovable 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 hotels as well as 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. Immovable property in the Netherlands, therefore, constitutes an attractive object of investment for investors striving for a stable investment in the long term.

Chapter 23

POLAND

Janusz Siekański and Radosław Waszkiewicz[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Title to real estate

Polish law provides for two forms of title to real estate: ownership and perpetual usufruct. The ownership form is unlimited in time, while the perpetual usufruct is limited in time.

The ownership right provides the entitled entity with the broadest scope of authority over real estate. It allows the owner to, *inter alia*, use the real estate exclusively, develop it and collect profits from it. The owner is limited in its right only by law and principles consistent with public policy, and should exercise its right in accordance with the social and economic purpose of a given real estate. The owner may freely dispose of its real estate. The ownership right to real estate extends to the spaces over and under its surface, and also to buildings or any other installations or structures erected on the land that are firmly attached thereto (*superficies solo cedit* principle).

The perpetual usufruct right is akin to the ownership right, but is limited by time and the purpose for which it has been established. Moreover, it may only be established on real estate owned by public entities (the State Treasury or local governments). The entitlements of the perpetual usufructuary are similar to those associated with an ownership right; however, an agreement on the establishment of the pertinent right may impose specific limitations. In particular, a perpetual usufructuary is allowed sole use of the real estate and may dispose of its title. The key right of the perpetual usufructuary is the right to erect buildings on the real estate. Such buildings and structures are then held in ownership by the perpetual usufructuary, and such ownership is separate from the ownership of the land (this is one of few exceptions to the rule of ownership of the land extending to structures firmly attached thereto). A perpetual usufruct right is usually established for 99 years; a shorter term (however, not less than 40 years) is possible if the economic aim does not require that the pertinent right be established for the maximum period. The right is also subject to renewal (the perpetual usufructuary needs to submit such a request not later than five years prior to the lapse of the original term). A perpetual usufruct right is subject to two types of fees that are not applicable in the case of an ownership right. The first fee constitutes a one-off payment to be made upon establishment of the perpetual usufruct, and usually varies from 15 to 25 per cent of the land's value. The second fee is an annual fee in an amount varying from 0.3 to 3 per cent of the market value of the land. The rate depends mainly on the purpose for which the land

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and the structures erected thereon are actually used. In addition, upon fulfilment of certain conditions, entities that were holders of perpetual usufruct rights on 13 October 2005 may apply to have their perpetual usufruct converted into an ownership right upon payment of an additional fee; however, in March 2015 this right was limited only to natural persons (to the exclusion of entities) by the Constitutional Tribunal.

The Polish system also recognises co-ownership (i.e., joint ownership by more than one entity) and joint perpetual usufruct rights.

When certain technical and formal requirements are fulfilled, it is possible to establish separate ownership of premises. This right is most commonly used in housing developments where owners of separate apartments constitute a compulsory commonwealth holding the land on which a given multi-apartment building is located in co-ownership or joint perpetual usufruct. However, such a right is also frequently applied to commercial premises in big commercial complexes, where the ownership of premises is held by different entities that are co-owners of the land on which such a commercial complex is located.

The Civil Code also provides for additional types of rights with respect to real estate (i.e., limited rights *in rem*). These rights include usufruct, easements, mortgages and cooperative types of ownership of separate premises. Usufruct is a narrower right than ownership, but is broader and stronger than a lease. Easements in general either increase the usefulness or possibilities of the development of land, or secure access to roads or infrastructure. A mortgage is a standard security instrument. Cooperative ownership of premises applies to houses and apartments built and owned by cooperatives, and is a way of granting the cooperative members rights to either houses or apartments within premises.

ii System of registration

With certain exceptions, any real estate is registered in the relevant land and mortgage register maintained by the competent district court. This register, divided into five sections, contains information on the location of real estate, its ownership status, possible encumbrances and claims of third parties, as well as mortgages. While the actual ownership and legal status of the real estate may in practice differ from the disclosure in the land and mortgage register, the entries in the register regarding title and encumbrances on the real estate enjoy a legal presumption of correctness, generally benefiting purchasers with the presumption of their having acted in good faith. However, if there is an 'annotation' (also called a 'remark') in a relevant land and mortgage register indicating that legal proceedings concerning a change of the corresponding information disclosed therein are pending, the above privilege of *bona fide* purchasers is waived. A description of the factual status of the land contained in the land and mortgage register, such as its borders, plot numbers and area, does not enjoy a legal presumption of correctness.

The contents of the land and mortgage registers with respect to the entries made are available to the public, both in the form of an excerpt obtained from the relevant court and online. However, this public access principle does not pertain to the actual files of source documents held by the district court (in particular, the documents that constituted the basis for making the respective entries, such as notarial deeds regarding transfers of title or establishment of encumbrances): such documents are available solely to entities holding title to the corresponding real property or entities that can demonstrate a justified legal interest in gaining access to pertinent files.

As a prevailing rule, entries in the land and mortgage register are not required for the effectiveness of transactions undertaken with respect to real estate, as they do not have constitutive character (i.e., they are only declaratory). The most typical exemptions from this rule are entries regarding the establishment or transfer of a perpetual usufruct right or mortgage, where the relevant entry is necessary for a given action to be fully effective.

Survey information about real estate, their locality, borders, area, plot numbers, type of soil and a description of the manner of actual use, is contained in the land and building survey. This is a register maintained by local municipal authorities, and the data from that register constitutes the basis for relevant entries in the first section of the land and mortgage register.

iii Choice of law

Although as a general rule parties to a contract are allowed to choose the applicable law, agreements concerning ownership rights or other rights *in rem* over real property, in accordance with the *lex rei sitae* principle, are mandatorily governed by Polish law. Additionally, an agreement transferring or merely creating an obligation to transfer the ownership of real estate should be executed in the form of a notarial deed, where the Polish notary public plays a significant role with respect to the conducting of the transaction and its later registration in the land and mortgage register.

II OVERVIEW OF REAL ESTATE ACTIVITY

After the best year for the Polish real estate market in history (with an annual volume of investment transactions around €4.6 billion), it was predicted that in 2017 the annual transaction volume would be similar to that of 2015–2016. The numbers for 2017 are not available yet, but the investment volume in the first three quarters amounted to approximately €2.4 billion. Slightly lower turnover in the first three-quarters of 2017 was caused by the increase in transaction time, and it is predicted that the total investment volume for 2017 may still be similar to that of previous years. Of the investment volume in the year to date, more than 50 per cent (€1.29 billion) was recorded in the commercial real estate sector. Around €0.67 billion was recorded in the office real estate sector.

Capitalisation rates for Warsaw office real estate are estimated at 5.2 per cent, with the vacancies rate reaching around 13 per cent. There are 1.7 million square meters of office space currently in construction. The warehouse real estate market grew because of demand from logistics firms and chain stores. In the third quarter of 2017, the vacancies rate in the warehouse real estate stayed at around 6.1 per cent. The vacancies rate for commercial real estate in the 18 largest regional markets was at a low 4.1 per cent.

III FOREIGN INVESTMENT

Foreign acquisition of ownership rights or perpetual usufruct rights to real property is subject to restrictions provided for under the Act on the Acquisition of Real Estate by Foreigners, under which a foreigner is required to obtain a permit to be able to acquire real estate located on the territory of Poland. The term 'foreigner' is understood to be both a natural person that is not a Polish citizen and a legal person seated abroad; it covers also legal persons or entities seated in Poland but controlled (directly or indirectly) by foreigners. The permit is issued by the Minister of the Interior, provided that no objection is raised by the Minister of National Defence (and additionally, in the case of agricultural and forest real estate, by the Minister of Agricultural Development). Moreover, such a permit may also be required in the case of indirect acquisition of any of the above-mentioned titles to real estate (i.e., where a foreigner acquires shares in a company that owns or is a perpetual usufructuary of real estate within the territory of Poland).

Citizens or entrepreneurs from countries belonging to the European Economic Area are exempt from the obligation to obtain such a permit. The remaining restriction regarding agricultural real estate was eliminated as of 1 May 2016. However, new legislation that came into force at the end of April 2016 introduced further obstacles in acquiring and selling agricultural land for both foreign and domestic entities, including a ban on the sale of agricultural land by the state during the next five years and restrictions regarding entities that may acquire agricultural land. Because of the new legislation that largely limited the possibility of acquiring land for commercial purposes as well as the statutory right of first refusal enjoyed by the State Agricultural Land Agency, any transactions pertaining to agricultural real estate will require a higher level of due diligence and proper planning.

Tenants of agricultural real properties generally enjoy the right of first refusal in cases of sales of such properties, provided that the tenancy lasts at least three years.

IV STRUCTURING THE INVESTMENT

Similarly to other jurisdictions, real estate transactions in Poland are typically either structured as asset deals or share deals. In an asset deal, the real estate is acquired directly from its owner (being either an individual or a legal entity). In a share deal, the transaction encompasses shares in an entity that owns real estate. The decision as to which type of transaction to carry out will depend on the business needs of the parties to the contemplated transaction, and will vary on a case-by-case basis. Some of the most important factors to take into account would be the timeline of the transaction, its tax implications and the scope of due diligence to be conducted.

For tax reasons, two types of special purpose vehicles are most common on the Polish market as holders of real estates: limited liability companies and limited partnerships. These are considered as not causing obstacles with regard to their operation, and they are especially popular among investors (including foreign funds) as they are not subject to special regulatory restrictions with respect to the form in which the investment process shall be conducted. The income of limited liability companies is subject to corporate income tax, and in cases where dividends are payable or paid to the shareholders, income tax must further be paid thereon. A limited partnership is composed of one or more general partners and one or more limited partners. A limited partnership is an entity that forms an organisational unit with no legal personality; however, it may acquire real estate in its own name. Limited partners bear no management authority and are solely liable for debts incurred by the partnership to the extent of their registered investment. Therefore, general partners carry more liability in cases of financial loss. Very often, the general partner is a limited liability company. A limited partnership is not subject to taxation of income at the partnership level (corporate income tax or personal income tax), and only the partners are considered as taxpayers with respect to their income. Such tax benefits are the main reason why investors most commonly decide to form a limited partnership as a special purpose vehicle for carrying out commercial real estate projects.

V REAL ESTATE OWNERSHIP

i Planning

The rules governing zoning and the general development of land are mainly determined at local municipal level; however, certain more general issues are resolved and determined at province and central government level. These matters are regulated by the Act on Spatial Planning and Development. Municipal zoning plans (adopted by way of a resolution of a given municipal council) are regulations specifying designation of land, and the manner of and restrictions on the development and use of land. Zoning plans outline the spatial policy of a given municipality and at the same time constitute binding local laws. If a local zoning plan is not adopted for a given area, then a party interested in developing the land needs to obtain either an individual decision on land development or (in the case of public interest investments) a decision on the localisation of the public interest investment. The process of preparation and adoption of local zoning plans includes consultations with the respective authorities, as well as the general public. Each entity may submit its observations regarding the plan under preparation, which may (but do not have to) be introduced into the draft of the plan. In accordance with the Property Management Act, municipalities enjoy a statutory pre-emptive right in cases of sale of real estate or perpetual usufruct rights thereto if the pertinent real estate is located within an area allocated in the zoning plan for public purposes or if a decision on the localisation of the public purpose investment has been issued. Such real estate may also be subject to expropriation.

The construction process and obligations of the owners of buildings and structures are regulated in the Construction Law. Generally, it is necessary to obtain a construction permit for most (if not all) larger commercial, industrial or housing investments. If a planned investment is in accordance with the provisions of the zoning plan (or, if a zoning plan does not exist, if the basic parameters and designation of the investment are confirmed in the individual zoning decision), a complete construction design is prepared and neighbours that are within 'impact zones' of the planned investment do not raise serious and justified objections, the planned investment can be approved.

On 9 October 2015 the Polish parliament adopted a law on revitalisation that regulates the principles and procedures for restoration of 'degraded' areas (i.e., areas where a concentration of negative social phenomena occurs, such as unemployment, poverty, crime, poor education or where the environmental quality standards have been exceeded). The decision on whether an area is considered degraded or earmarked for revitalisation is taken by a competent municipal council via a resolution constituting a local law deed. The resolution empowers the municipal council to grant the pre-emptive right to all of the real properties located in the revitalisation area to the municipality competent for the venue. Furthermore, under the new legislation, it will be possible to establish 'special revitalisation zones' in the areas subject to revitalisation, for a maximum period of 10 years, within which administrative procedures will be facilitated, subsidies for renovation works will be possible and exemptions from tender procedures on the sale of real properties will be in place. In these zones, *inter alia*, rental housing is to be developed. These activities will result in a substantial improvement in the quality of life of the inhabitants.

ii Environment

There are two regimes of liability for soil contamination, depending upon the period in which the contamination originates. Soil contamination that occurred prior to 30 April 2007 or that may be attributed to activity completed prior to that date is regulated by the Environmental Law. Pursuant thereto, the current holder of land (the person disclosed in the land register – usually the owner of the land or its perpetual usufructuary) should comply with the soil contamination standards defined in the implementing legislation. If the soil contamination exceeds statutory limits, the holder of the land right is obligated to reduce the contamination to acceptable standards, unless such an entity proves that the soil contamination was caused by a third party after the acquisition of the right to the land by the current holder of the land. Consequently, liability for 'historical' contamination will usually rest exclusively with the current holder of the land. Contamination that occurred after 30 April 2007 (or that could be attributed to an activity completed after that date) is subject to the Act on Prevention and Remediation of Environmental Damage of 2007, which imposes a strict duty to undertake preventive or remedial actions with respect to contamination of soil, in particular contamination that may constitute danger to human health. The duty pertains in particular to preventive or remedial actions with respect to an imminent threat of environmental damage or to environmental damage caused by activities that 'pose a risk to environment'. If the preventive actions do not eliminate the imminent threat to the environment or the environmental damage has already occurred, the operator should immediately notify such a fact to the competent authority. Subsequently, the terms and conditions of remedial actions should be negotiated and agreed upon between the operator and the authority. Failure to implement remedial action gives the competent authority the power to order the operator unilaterally to take appropriate remedial actions or to cover the cost of remediation effected by the authority. The provisions of the pertinent Act refer solely to the operator without further specifying its legal title to the land.

iii Tax

As a rule, transactions involving the sale of real estate between entrepreneurs are subject to VAT. There are two main exceptions under which the sale of the real estate is exempt from VAT, although the purchaser will be obliged to pay a tax on civil law transactions (PCC) amounting to 2 per cent of the market value of the real estate constituting the subject of the transaction. This may be applicable in either of the following situations: if the seller is not a VAT taxpayer, or if the subject of the sale is a specific type of land that is undeveloped and is not designated for development (this mainly pertains to agricultural and forest areas). Moreover, in the case of an acquisition of an enterprise as a going concern, if such a transaction also covers the purchase of real estate, it shall be subject to 2 per cent PCC. Sales of real estate are generally also subject to capital gains tax.

An owner of real estate is also obligated to pay real property tax annually, which is a municipal tax calculated based on the area of real estate owned, the area of the buildings located thereon and the percentage of the initial book value of other structures.

Additionally, as mentioned above, agreements on transfers of real estate must be executed in front of a notary public in the form of a notarial deed; otherwise they will be considered null and void. The notarial fees are calculated on the basis of the value of the subject of the transaction; however, they cannot exceed 10,000 zlotys (the fees are customarily covered by the entity acquiring the real estate). In addition, there are registration fees relating to disclosure of the newly acquired rights in the relevant registers (i.e., the land and mortgage register and the land and building survey).

iv Finance and security

Transactions covering transfers of title to real estate are typically financed either through the buyer's own resources (corporate funding) or from bank credits (project financing), with project financing being used more frequently. To secure claims of a bank or any other financing institution or entity, a mortgage is most commonly established over the real estate, which is also considered as one of the most certain types of security. An additional advantage of the mortgage is that the debtor is not prevented from using the pertinent real estate. A mortgage is a limited right *in rem* that encumbers real estate (or perpetual usufruct right), enabling the creditor to satisfy its claims from the real estate regardless of the current owner thereof. A mortgage may be established by way of agreement between the parties or by way of a statement of a landowner executed in the form of a notarial deed that must be recorded in the relevant land and mortgage register (constitutive entry). The notarisation requirement does not apply to mortgages established in favour of banks seated within the territory of Poland as, in accordance with the Bank Law, a written statement stamped with the bank's stamp is sufficient for establishment of the mortgage and its entry into the land and mortgage register.

Other types of security in favour of banks crediting acquisitions of real estate are:

a a voluntary submission to enforcement (a statement by the debtor made in the form of a notarial deed allowing court proceedings to be bypassed and to proceed directly to enforcement of the debt);
b a pledge over the shares of the debtor (if it is a legal entity);
c an assignment of rights to collect profits from the real estate (most common in acquisitions of commercial or office buildings);
d third-person guarantees; and
e promissory notes (used less and less frequently).

VI LEASES OF BUSINESS PREMISES

The fundamental principles with respect to leases are regulated by the provisions of the Civil Code. However, since they allow the parties to the relevant agreement broad (but not unlimited) scope to determine their rights and obligations, leases of business premises concluded between entrepreneurs usually include a number of clauses specific to such types of lease. Above all, these refer to the areas mentioned below.

i Term and termination

Lease agreements may be concluded for a definite or indefinite period, but the longest definite term in lease agreements between entrepreneurs is 30 years. After that time, a lease agreement is deemed to be concluded for an indefinite period. A lease concluded for an indefinite period can be terminated by either party upon the pertinent notice period being given. Since the commencement of activity in the premises is usually connected with certain investments made by the tenant, the most common solution in business leases is to conclude an agreement for a definite period, with possible extension options. Leases concluded for a definite period cannot be terminated unless for reasons stipulated in the applicable law or in the lease agreement. The main statutory reasons for termination by the landlord are as follows: failure of the tenant to pay rent, or use of the premises that is contrary to the agreed purpose. The main statutory reasons for termination by the tenant are as follows: in the case of defects to the premises that pose a threat to health or life, or that significantly hinder the use of the premises, and that are not removed by the landlord. To be effective, the termination triggers agreed by the parties in the agreement need to be rather specific and precise, and they usually relate to specifics of the business (e.g., for termination by the landlord: if an anchor tenant in a commercial centre stops its operations or changes its business profile; or for termination by the tenant: if certain key services are not provided to the premises by the landlord).

If a title to real estate encumbered with a lease is transferred to another entity, the new owner assumes the position of landlord and becomes party to the respective lease agreements by operation of law. In this context, it is recommended that lease agreements made for a specified period are certified by a notary public or are recorded in the pertinent land and mortgage register; otherwise, after assuming the position of landlord, the new owner of the real estate could be entitled to terminate the lease upon statutory notice.

ii Rent and service charges

Commercial leases are usually structured as 'triple net leases'. The tenants are obligated to pay the rent, cover the costs of utilities and pay service charges covering the costs of various services provided to the building by the landlord. Such services include tasks related to the maintenance of and repairs to the building, cleaning, media delivery, building systems operation, security and insurance. In the case of premises or facilities located in stand-alone buildings where the tenant is the only user of services, the parties may decide that all obligations related to the upkeep and maintenance of the building are vested with the tenant, and that only rent will be paid to the landlord. Rents are usually expressed in flat rates subject to annual indexation (pegged either to Polish or EU retail prices statistical indices, depending on the currency of the rent). In some commercial leases, rents are calculated as a percentage of the tenant's turnover.

iii Taxes

The rent normally constitutes income and tax-deductible costs within the context of income tax; as a service, it is subject to VAT on a regular basis.

iv Security

As a rule, in the case of leases of business premises, the tenant is usually obligated to provide the landlord security covering its obligations under the lease, and in particular the obligation to pay the rent and service charges. Typical security instruments used are cash deposits, bank guarantees, *in blanco* promissory notes and notarial deeds including a statement on voluntary submission to enforcement. Sometimes parent companies guarantees are accepted, but this depends mainly on the financial standing of the tenant and that of the whole group that stands behind it.

v Subletting

With respect to premises, general provisions of the Civil Code do not allow the tenant to sublease the premises or allow either the whole or part of the premises to be used by third parties without the consent of the landlord. This provision is most commonly retained by parties to commercial leases, where sublease or similar instruments are allowed only upon the consent of the landlord. Certain characteristics of an accepted assignee are sometimes defined (usually by reference to the credit rating of such a potential new tenant, a profile of its business and its financial standing).

vi Expenditures

Unless otherwise agreed in the lease agreement, in the event that the agreement is terminated, the landlord may either retain any improvements to the premises against payment of a sum corresponding to their value at the time of return, or demand that the previous condition of the premises be restored. However, the general rules are in most cases modified by the parties in the contract. The regulations on mutual settlements between parties and the state in which the premises should be left by the tenant after the termination of the lease are adapted to specific circumstances that depend on the scope of any improvements and their specifics. Tenants of smaller premises of more standard parameters need to accept that they may have to leave the premises without any compensation for the value of their investment. Large and anchor tenants are able to negotiate much better terms, including the landlord's participation in such an investment, at the beginning of the lease.

VII DEVELOPMENTS IN PRACTICE

Because of the recent change to the ruling party, bringing the prospect of an ambitious and far-reaching programme of reform, it is difficult at present to envisage changes to the legislation relating to real estate in the coming year. The workings of the parliament are very dynamic at present and changes should be monitored as they develop. In particular, works on a new comprehensive bill concerning construction law and spatial planning that was introduced in September 2016 continued throughout 2017. The bill should be closely monitored as its adoption will have a significant impact on the investment process.

A bill on reprivatisation of real property nationalised after World War II is being prepared by the government, but the parliamentary process has not yet started. The bill generally has the aim of extinguishing any restitution or compensation claims relating to the nationalised property in exchange for a payment of 20 per cent of their value to certain eligible heirs. Such bill, if introduced, may contribute to clarification of legal title to currently disputable land, thus enhancing the investment, but would in itself create new legal problems too. Therefore, the progress of parliamentary works should be closely monitored.

Also in the context of reprivatisation, the parliament has established a special commission that has the competence to overrule certain restitution decisions issued to date in connection with real property in Warsaw. The commission operates very quickly and has overruled a number of such decisions to date owing to alleged violence of law; such decisions of the commission have not been verified by administrative courts yet. The activity of the commission requires a higher degree of diligence from investors in Warsaw if the investment land has, in the past, originated from reprivatisation.

VIII OUTLOOK AND CONCLUSIONS

As indicated above, the Polish real estate office market has grown over the past few years. Investors in the business services sector and in research and development frequently choose Poland for their office location, and Poland now ranks as the third most popular destination worldwide in this regard.

Although the limitations on transfers of agricultural land that currently apply to EU entrepreneurs in Poland have expired, new legislation concerning purchasing of agricultural land was introduced and limited the possibility of acquiring such land for commercial purposes and should be taken into account in investment process.

Poland suffered greatly during the Second World War and under the subsequent communist regime, as a result of which the historical ownership status of real property may frequently be very complicated. A lot of land has been subject to nationalisation or similar measures in the past, and restitution claims of the heirs of previous owners are very frequent. Poland has not adopted a general restitution law to date, which can also make the ownership situation very complicated. Special due diligence is often recommended when looking at historical claims before purchasing real estate in Poland, and, in addition, the recent actions of the government should be taken into account to avert certain past restitutions in Warsaw and to introduce a new law on reprivatisation.

Chapter 24

QATAR

Nicola de Sylva[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

The general rule for real estate ownership in Qatar is set forth in Law No. 5 of 1963, which permits only Qataris to own freehold real estate in Qatar. However, to attract investment the government opened the country's real estate market to foreign investors in 2004,[2] permitting foreigners to own freehold real estate or to hold usufruct rights for 99 years in particular areas (investment areas).

A further development to attract investment into the real estate sector was the issuance of Law No. 6 of 2014 (the Real Estate Development Law) to regulate real estate developers. This Law regulates issues involved in selling units in real estate projects that were and are under construction (off-plan units) to provide greater security to investors investing in real estate in Qatar.

Freehold ownership entitles the buyer to have title to the land as well as ownership of structures on the land. However, the buyer and the purchaser may agree that the buyer owns the land only without having ownership of the structure to be built thereon provided that the same is set out clearly in an agreement between the parties.

ii Registration of real estate

Law No. 14 of 1964 (the Real Estate Registration Law) establishes a framework relating to property registration in Qatar whereby all dispositions giving rise to real property rights, including usufruct rights, must be registered, including most recently off-plan property sales. This registration is usually conducted at the Real Estate Registration and Authentication Department at the Ministry of Justice.

Registration of freehold property

The process of registering a freehold property entails the submission of an application form with a minimal fee, along with the original of the title deed and the sale and purchase agreement (on the Ministry of Justice's letterhead). In the event that the parties are not present before the Real Estate Registration and Authentication Department, the authorised legal representative should be accompanied by a valid power of attorney (bilingual or in Arabic) with the authority to complete the sale of the concerned property.

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2 Law No. 17 of 2004 Regulating Ownership and Usufruct of Real Estate and Residential Units by Non-Qataris (the Foreign Ownership of Real Estate Law).

In the event that one of the parties is a company, a copy of the company's commercial registration and immigration or computer card will have to be submitted. A shareholders' resolution approving the sale will also be required. The person signing and approving the sale on behalf of the company should be authorised, under the company's incorporation documents, to sell the company's assets, or, alternatively, authorised under a shareholders' resolution to undertake the sale. The purchaser is the party required to pay 0.25 per cent of the property value as a transfer fee.

Registration of usufruct

While rights of usufruct are to be registered with the Real Estate Registration and Authentication Department, rights of usufruct in the investment areas that are open to foreign investors (see below) must be registered with the relevant municipality at the Ministry of Municipality and Urban Planning (MMUP), where a certificate is to be issued in this regard. The MMUP has a standard usufruct agreement in the event that parties do not have their own in place. Once the usufruct agreement is signed, the MMUP will send a copy of the agreement to the Real Estate Registration and Authentication Department. Any registration, sale or assignment of usufruct rights requires payment of 1 per cent of the property value at the time of registration. This fee is to be paid by the person benefiting from the usufruct right.

Registration of off-plan units

The Real Estate Development Law established an interim register at the Real Estate Registration and Authentication Department. Pursuant to this Law, real estate developers are required to submit an application to register strata titles for projects being developed before units in the project can be sold on an off-plan basis. Any transaction in respect of an off-plan unit that is not recorded in the interim register will be considered invalid. While in principle this Law is in force, as it was published in the Official Gazette on 7 April 2014, there have been no executive regulations issued in relation to its application and the competent authorities have not started implementing any of its provisions.

Advantages and consequences of failure to register

In the event that real property rights are not registered with the competent departments as noted above, the relationship between the parties will remain only contractual. In other words, without registering real property rights, any recourse to action would only be available against the counterparty in contract, and damages would be the only remedy available. Furthermore, no enforcement against a third party will be possible.

iii Choice of law

Law No. 22 of 2004 (the Civil Law) provides that property possession, ownership and other real rights and the disposal and termination of the same are to be governed by the law of the place in which the property is located. Ownership or disposal of real estate property or rights thereon located in Qatar, whether within or outside the investment areas, will be subject to Qatari law. Therefore, parties should plan their transactions related to real estate, including their rights and obligations thereon, to be governed by Qatari law.

II OVERVIEW OF REAL ESTATE ACTIVITY

Real estate sales activity in Qatar has been falling since 2014. The recent measures taken by Saudi Arabia, Bahrain, Egypt and UAE have resulted in a further decline in market confidence, with transactional activity and values being impacted.[3]

Despite recent economic conditions, retail rents within organised malls have remained stable. However, supply of organised retail accommodation increased by more than 1 million square metres earlier in 2017, with a number of additional malls expected to open in the next 12 months. The quantity of retail construction in the development pipeline is likely to result in total supply of more than two million square metres by 2022, which has led to fears of an oversupply.

The office market has seen a decrease in occupancy and enquiry and an increase in vacancies. While many new office buildings are being developed and constructed, the demand for this type of space does not meet the fast-increasing supply, and so landlords are competing for tenants. According to DTZ's report, recent building completions in Lusail have increased the supply, with a total supply of purpose-built office accommodation estimated to be in excess of 4 million square metres. DTZ estimates that there is currently 370,000 square metres of office accommodation available to lease in West Bay and Lusail, which reflects an availability rate in excess of 20 per cent. Approximately 2 million square metres of new office accommodation is planned for Qatar within the next decade, largely in Lusail. If completed, DTZ anticipates that occupancy rates will come under further pressure. A number of office developments have been put on hold over the past 12 months owing to fears of oversupply in the short to medium term.[4]

Similar to the office market, residential rent has also seen decrease of rent rates by 10 to 20 per cent. A large quantity of new residential spaces is being made available, especially in the non-central areas where landlords have shown flexibility and willingness to lower prices. This resulted in lowering the demand in the central areas such as the Pearl-Qatar and West Bay. This is a result of the current economic environment.[5]

III FOREIGN INVESTMENT

As previously mentioned, the ownership of real estate property in Qatar is generally restricted to Qatari nationals. However, the Foreign Ownership of Real Estate Law was passed in 2004 to permit foreigners and Gulf Corporation Council (GCC) citizens (whether individuals or companies) to own properties in certain investment areas as defined in related ministerial resolutions. Non-Qataris cannot own real estate properties outside these designated investment areas.

The Foreign Ownership of Real Estate Law defines 'investment areas' as 'lands allocated for carrying out commercial, industrial, tourism, residential and educational activities and any other activities the investment in which is permitted in accordance with the applicable laws in the State'.

3 DTZ Research by Johnny Archer, *Property Times*, 'Real estate feels the impact of recent blockade.' Qatar Q3 2017.
4 Ibid.
5 Ibid.

Resolution No. 5 of 2006 permits GCC (individual or juristic) citizens to freehold ownership in the following areas: Lusail, Khuraj and Fox Hills (areas permitted to GCC citizens). Any registration of property, registration of real rights or transfer of ownership will be handled by the Real Estate Registration and Authentication Department through Qatari Diar Real Estate Investment Company, which is the company entitled to manage each of the mentioned areas permitted to GCC citizens.

In addition to the areas permitted to GCC citizens, GCC citizens are also entitled to freehold ownership in the areas designated for foreign investors. Ministerial Resolution No. 20 of 2004 determined such areas to be the Pearl, West Bay Lagoon and Al Khor. Similar to the registration process in the areas permitted to GCC citizens, any registration of property or real rights is to be administrated by each area's administrator. United Development Company (UDC), as the master developer, is the administrator for Pearl, and is required to liaise with the Real Estate Registration and Authentication Department in respect of purchased properties in the Pearl area. In practice, very few plots of land have been subdivided in the Pearl area, and no title deeds have been issued to purchasers of the units. The units are still considered by the Real Estate Registration and Authentication Department to be owned by UDC until they are subdivided and title deeds are issued in this regard.[6]

Another option available to non-Qataris is the right of usufruct of real estate for a term of 99 years, renewable for a similar period, in 18 investment areas determined by Ministerial Resolution No. 6 of 2006 (the Lusail development is one of these areas). There are no specific usufruct areas that are permitted only for GCC nationals; all of the above areas are open to all foreigners.

IV STRUCTURING THE INVESTMENT

Law No. 13 of 2000 (Foreign Investment Law as amended) regulates foreign investment within Qatar and sets down a general principle that foreign investors are allowed to invest in all sectors of the national economy provided they have one or more Qatari partners owning a minimum of 51 per cent of the entity's capital. Accordingly, non-Qataris wishing to incorporate an entity in Qatar are generally restricted to owning a maximum of 49 per cent of any such entity.[7]

Under the Foreign Investment Law, non-Qatari companies are not permitted to invest or trade in real estate. However, since the government's approval of foreign ownership of real estate by virtue of the Foreign Ownership of Real Estate Law, some foreign investment activities can take place in the real estate market provided that the investing company is established in Qatar and the company adheres to the restrictions that apply to foreign ownership, such as the inability to purchase land outside the investment areas. For example,

6 This practice should change once the Real Estate Development Law is fully implemented.

7 As an exception to the above rule, the Foreign Investment Law provides a number of exemptions for foreigners wishing to undertake commercial, economic or professional activities within Qatar in specific fields to hold up to 100 per cent of such entities. An approval must be obtained from the Ministry of Economy and Commerce allowing the 100 per cent ownership. The Foreign Investment Law lists the categories that would qualify for such a ministerial exemption, including agriculture, industry, health, education, tourism, development and exploitation of natural resources, energy or mining, IT services, technical services, consulting services and distribution services (noting the Minister has recently indicated that distribution services will no longer be approved), provided that such projects match the objectives of the development plan of the state of Qatar.

a GCC fund would be able to own freehold properties in both the areas permitted to GCC citizens and the areas permitted to foreigners where the underlying ownership of the fund lies with GCC nationals. However, if the underlying ownership of the fund involves non-GCC citizens, then freehold would be restricted to the areas permitted to foreigners.

The incorporation of companies that are fully owned by foreign shareholders (whether GCC or other nationalities) in Qatar whose objects include investing or managing real estate assets, or both, within the areas permitted to GCC citizens or areas permitted to foreigners, require the approval of the Ministry of Economy and Commerce. Normally, the articles of association of such companies will contain objects for investing in, managing and leasing of real estate assets in the particular permitted area. The Ministry of Economy and Commerce has discretion with regard to the documents that must be provided before registering a company above the limits of the Foreign Investment Law.

The Real Estate Development Law permits non-Qatari companies to obtain a specific licence to conduct real estate development activities provided that:

a the activities of the real estate development are within the investment areas where freehold ownership is available for non-Qatari nationals and within the land space permitted to be owned;

b the activities are conducted by a company permitted to conduct real estate development activities in its place of incorporation. The incorporation documents should be authenticated by the Qatari diplomatic mission or consulate in the country of incorporation, or by an equivalent authority in the country of incorporation;

c the company has at least 10 years of previous experience in construction and building developments prior to the submission of its application to conduct real estate development activities in Qatar, and additionally has a good track record of performance; and

d the company is to be incorporated in Qatar with a commercial registration.

Real estate developers and contractors are expected to become compliant with the Real Estate Development Law within six months of it coming into force. The Law provides for financial and criminal penalties for those who practise real estate development activities without a licence being issued.

i Common forms of companies registered in Qatar

All juristic entities incorporated in Qatar (other than Qatari Financial Centre entities) must be established pursuant to the provisions of the Commercial Companies Law (the Companies Law).[8] Foreign investors are often interested in incorporating a limited liability company (LLC) for the purpose of developing or conducting real estate activities in Qatar.[9]

The incorporation of a Qatari LLC requires registration with the Ministry of Economy and Commerce to obtain a commercial registration certificate that includes the company's activities to engage in real estate development, including acquisition, disposition and rental activities. At least 51 per cent of the shares in the Qatari LLC must be owned by Qatari nationals or a company wholly owned by a Qatari national.

8 Law No. 11 of 2015 regulating Commercial Companies.

9 The Companies Law provides for other types of companies: general partnership, simple limited partnership, limited partnership with shares, joint stock company (private and public), unincorporated joint venture, single person company and holding company.

V REAL ESTATE OWNERSHIP

i Planning

The Real Estate Development Law places certain restrictions on real estate developers, including the licensing requirements outlined above. Under the Real Estate Development Law, developers may only sell off-plan units after obtaining the consent of the Real Estate Registration and Authentication Department. Developers are required to submit to the Real Estate Registration and Authentication Department an application to create strata title for the project being developed before selling any off-plan units in the project. The application should be accompanied with the relevant architectural plans, engineering drawings and a certified copy of the building permit. A strata title will then be issued in collaboration with the Ministry of Municipality and Urban Planning.

The Real Estate Registration and Authentication Department maintains an interim register for recording details of the strata title and all details related to transactions in respect of the off-plan units. Once the project has been completed, the interim title deeds are converted into permanent title deeds. Off-plan units approved and registered in the interim register can be subject to all legal actions, including the mortgaging and selling of the units. The Real Estate Registration and Authentication Department is required to issue interim title deeds to be converted to regular title deeds once a project is completed.

ii Environment

There is no particular law in Qatar that deals explicitly with contaminated lands. However, the Environment Law[10] and its executive regulations place certain compliance obligations on owners of land and projects to protect the environment. There is no legal requirement to conduct investigations for potential contamination in connection with the sale of property.

The sale of real property is subject to the general provisions of the Civil Law regulating the parties' rights and obligations in any sale contract. Pursuant to Article 455 of the Civil Law, a seller remains liable to the purchaser where the subject of the sale, at the time of delivery, is defective in a way that would diminish the sale value or render the sale unfit for the purpose of its use. The seller would be liable for such a defect even if the seller was unaware of the defect's existence. However, if the purchaser was aware of such a defect at the time of the sale, or if the purchaser could have reasonably expected such a defect, the seller would not be liable towards the purchaser unless the purchaser has relied on the seller's assurance that such a defect does not exist or in the event that the seller intentionally did not disclose the defect to the purchaser.

iii Tax

Pursuant to the Income Tax Law of 2009, income and capital gains derived by investors in Qatar who are Qatari nationals or legal entities that are wholly owned by Qatari nationals are not subject to tax. GCC nationals and all businesses owned by GCC persons are also exempted from paying tax in Qatar. Pursuant to the Income Tax Law and Regulations issued in relation to the Law, profits derived from sources in Qatar would be subject to tax at a rate of 10 per cent. In practice, to determine the tax payable by a corporate entity in Qatar, the Tax Department of the Ministry of Economy and Commerce looks at the underlying interest in the same. Where the underlying interest lies with GCC persons, no tax will be payable.

10 Law No. 30 of 2002.

Where the underlying interest lies with other foreigners, tax will be levied at the 10 per cent rate applied to profits. Where there is a mix of GCC and other foreign ownership, the Tax Department exempts a percentage of profit from the imposition of tax pro-rated with the GCC ownership. For example, if profits of a company are 100,000 Qatari riyals and GCC ownership of the company is 60 per cent, then 60 per cent of the profit will be exempt from tax. Accordingly, applying the tax rate to 40 per cent of the profit (i.e., 40,000 Qatari riyals) results in a tax of 4,000 Qatari riyals.

iv Finance and security

The Civil Law and the Commercial Law[11] recognise various categories of securities based on the type of property to be secured (movable and immovable properties). In respect of real estate, the creation of security is mostly seen in the form of mortgages or assignments of rights (conditional assignment).

Mortgages are generally the most common form of security whereby under a mortgage agreement, the mortgagor charges its interest in real property as security to a creditor (mortgagee). The mortgagee acquires the right to sell the real property in the event that the mortgagor is unable to satisfy its indebtedness. A mortgage agreement will have to be officially registered at the Ministry of Justice to give the creditor priority rights over the mortgaged property. In the event of default, the mortgagee shall have the right to request the court to sell the property subject to the mortgage provided that:

a an official notice has been given to the debtor;
b seven days have elapsed since the debtor's notification date;
c a court decision to sell the property has been notified to the debtor; and
d a five-day period has elapsed since the debtor was notified of the same.

An assignment of rights or conditional assignment is an inferior form of security to a registered mortgage as it is a contractual agreement that does not entitle the creditor to sell the property in the event of the debtor's default. To enforce an assignment of rights, a claim must be filed before a court to evidence the debt that is the subject of the assignment.

Under the Civil Law, an assignment of rights is only effective towards the debtor or a third party if the debtor has acknowledged such an assignment. Such an acknowledgement must be date certified. Date certification is carried out by the Real Estate Registration and Authentication Department. The authentication of the assignment grants the assignment an official date, so the priority of the creditor is established from the date of the authentication. An assignment of rights is commonly used in respect of non-official sale contracts where title deeds have not been issued in the name of unit holders (e.g., mortgages on Pearl units where there is no title deed issued yet in the name of the purchasers).

VI LEASES OF BUSINESS PREMISES

i Applicable law

Law No. 4 of 2008 as amended (the Lease Law) is the primary legislation in Qatar that regulates the relationship between landlords and tenants. The Lease Law applies to all lease contracts in Qatar that are of a term of at least one month, excluding leases applying to:

11 Law No. 27 of 2006.

a state, private and public properties;
b agricultural land;
c undeveloped land;
d industrial services land;
e hotels and touristic apartments and units; and
f residential units reserved by the state or other companies for their employees.

ii Mandatory provisions under the Lease Law

Eviction of tenants during a lease term

The Lease Law imposes certain rights and obligations upon the landlord and the tenant that are mandatory (parties cannot contractually agree to exclude these from the application of certain provisions). One mandatory provision is Article 19 of the Lease Law, which provides for exclusive circumstances pursuant to which the landlord may request the competent leasing committee established under this Law to evict a tenant from the leased premise during the tenant's lease term. These grounds are as follows:

a in the event that the tenant does not perform its obligations in respect of rental payments;
b in the event that the tenant relinquished his or her interest in the lease (e.g., by assigning it to another person) without the written approval of the landlord;
c if the tenant uses the premises, or permits the premises to be used, for purposes contrary to those set out in the lease or that are otherwise inconsistent with public order or morals;
d if the competent authorities decree that the property must be demolished, or the premises are determined to be in danger of collapsing, causing a hazard to public safety;
e if the landlord decides to demolish the building (in limited circumstances);
f if the landlord decides to modify or extend the building (again, subject to certain restrictions outlined below); or
g if the leased premises are located within the landlord's private dwelling, and he or she or a member of his or her immediate family decides to utilise it for personal purposes (subject to the provision of due notice to the tenant).

The legislator's intention is to protect tenants from any sudden eviction at the discretion of the landlord during the lease term.

Rent increase

Article 10 of the Lease Law does not permit landlords to increase the rent value for leases in respect of leases in force prior to or after the enactment of the Lease Law except in accordance with the rules, terms and rates to be issued by the Council of Ministers.[12] In 2008, the Council of Ministers issued Decision No. 9 of 2008, which restricted rent increases upon renewal in respect of residential and commercial leases. This Decision prevented landlords from increasing rent for leases entered into on or after 1 January 2005, except after two

12 Law No. 4 of 2006 (the 2006 Lease Law), which has since been repealed, capped rental increases in any renewed lease to a 10 per cent increase of the amount agreed upon in that lease. The 10 per cent increase applied to all types of leases, whether residential or commercial, and whether the leases existed before or after the 2006 Lease Law came into effect.

years from the date the Lease Law became effective, unless the parties agreed otherwise. The same Decision also set out the rent increase limits permitted for leases entered into before 1 January 2005. Council of Ministers Decision No. 9 of 2010 replaced the earlier 2008 Council of Ministers Decision (2010 Decision). Pursuant to the 2010 Decision, rent increase restrictions upon renewal applied only to commercial leases. The 2010 Decision set out new rental increase limits; however, it restricted the application of such limits to commercial leases that were entered into before 1 January 2005,[13] with such an increase being effective from the date the increase is notified to the tenant. Pursuant to the 2010 Decision, a landlord is entitled to increase the rent for commercial leases entered into before 1 January 2005 every year upon renewal, provided that the landlord complies with the limits set out below:

a 20 per cent annual increase if the monthly rent is less than 3,000 Qatari riyals;

b 15 per cent annual increase if the monthly rent is between 3,000 and 6,000 Qatari riyals;

c 10 per cent annual increase if the monthly rent is between 6,000 and 10,000 Qatari riyals; and

d 5 per cent annual increase if the monthly rent is more than 10,000 Qatari riyals.

The 2010 Decision also prohibited rental increases for commercial leases entered into from 1 January 2005 onwards, except after a year from the date of the Decision, unless the leases provide otherwise. The 2010 Decision became effective on 15 February 2010. By virtue of a subsequent Council of Ministers Decision, the one-year period provided for under the 2010 Decision was extended for another year until 15 February 2012. As such, landlords were not permitted to increase rent upon renewal until 15 February 2012, unless the lease provided otherwise. Since the issue of this subsequent Decision, there have been no further decisions issued in this regard; however, rent increases with respect to commercial leases have been kept under control as a result of the Council of Ministers Decision extending all commercial lease terms by force of law, as noted below.

Protection of commercial tenants and extension of commercial leases by force of law

Article 27 of the Lease Law offered an exceptional measure of protection for commercial tenants[14] by preventing landlords from evicting such tenants with expired lease terms for a one-year period commencing on 15 February 2010 (eviction can only be carried out under specific grounds set out under Article 19 of the Lease Law). The same Article conferred authority upon the Council of Ministers to extend the relevant period thereafter, should it see fit. Accordingly, by virtue of Decision No. 22 of 2011, Decision No. 8 of 2012, Decision No. 15 of 2014, Decision No. 8 of 2015 and Decision No. 6 of 2016 the Council of Ministers extended the protective periods until 15 February 2012, 15 February 2014, 15 February 2015, 15 February 2016 and 15 February 2017 respectively. Thereafter, if no further extension is granted, landlords shall be able to evict tenants from leased premises upon expiration of the lease term.

13 While the percentage restriction should (pursuant to the 2010 Decision) apply to commercial leases signed before 1 January 2005, in practice, it appears that the percentages are adhered to for all commercial leases, whether signed before 1 January 2005 or after (the issue of rent increases should be considered in conjunction with the extension of commercial leases by force of law – see below for further details).

14 This protection was initially given to tenants under Article 3 of the 2006 Lease Law.

The above-mentioned decisions exempted the following from such extension:

a headquarters of commercial companies;
b engineering, lawyers' and accountants' offices;
c veterinary clinics; and
d offices of agricultural, fish and animal health experts.

VII DEVELOPMENTS IN PRACTICE[15]

i The Real Estate Development Law

The Real Estate Development Law introduced significant changes to the legal framework governing the development and financing of real estate projects in Qatar by providing protection to the purchasers of off-plan units, thus enabling developers to register the off-plan units in an interim register created by the Real Estate Registration and Authentication Department. Consequently, purchasers would obtain rights *in rem* in the project land rather than just having contractual rights under the sale and purchase agreements. However, to date, the Real Estate Development Law still has limited application in practice.

Other than the registration and licensing requirements, the Real Estate Development Law provides for other significant developments as follows:

a a requirement that each developer must open an escrow account for each project, and the purchase price paid by purchasers of off-plan units is to be deposited directly into the escrow account. Developers are only permitted to withdraw monies from the escrow account upon achieving construction milestones and subject to a schedule approved by the Ministry of Municipality and Urban Planning. Withdrawals may only be made once 20 per cent of the project has been completed, and such withdrawals may be made towards payment of construction costs, purchase costs of land and marketing expenses. Escrow accounts may not be provided as security for financing obtained by the developer for the project;
b developers are required to obtain the consent of the Real Estate Registration and Authentication Department prior to obtaining the financing for a real estate project subject to certain requirements provided for under the law. The law provides for the following conditions that would have to be satisfied by the developer to obtain such financing:
   - financing can only be obtained where off-plan units in a project remain unsold (i.e., there should be a number of units that have not been booked by purchasers, as this is relevant in determining the quantum of the loan);
   - the aggregate amount deposited in the escrow account should exceed the value of the construction works that have been completed, and the amount of construction works that has been completed shall be certified by a consultant;
   - the quantum of the financing obtained should not exceed the value of the unsold (or unbooked) off-plan units; and
   - the developer is required to submit a statement of the escrow account.

15 The text for Section VII was initially written by Rafiq Jaffer (partner) and Dina Al Wahabi (associate) for an Al Tamimi & Company Law Update article. The full article is available at: www.tamimi.com/en/magazine/law-update/section-8/july-august-3/regulating-real-estate-development-in-qatar.html.

c the law does not permit a developer to assign more than 50 per cent of the work in any project to a sub-developer without the approval of the Ministry of Economy and Commerce;

d developers have the obligation to hand over the units to purchasers on the date specified in the relevant sale and purchase agreement (in accordance with the agreed specifications), unless late handover is justified. The law provides for financial penalties in the event of late delivery; and

e the law provides for the establishment of a Real Estate Dispute Resolution Committee to hear disputes arising from the Real Estate Development Law and to establish real estate projects.

ii The Real Estate Brokerage Law

The Real Estate Brokerage Law[16] was introduced in 2017, with the aim of regulating the business and licensing of real estate brokers, which replaces the earlier law, Law No. 13 of 2011.

VIII OUTLOOK AND CONCLUSIONS

As anticipated, in 2017 there was a significant drop in the demand for real estate, both commercial and residential; and, accordingly, rentals have come down and incentives such as rent free periods are much more common and are being seen on a far wider scale. The continuing completion of various developments, in particular the large scale developments in Lusail and Msheireb, are expected to further increase the supply available in the market and increase the competition between landlords struggling to attract tenants. Landlords will ultimately have to show greater flexibility in negotiating the terms and conditions with the tenants and offering incentives. Although the retail market remained relatively strong in 2017, it is also expected to face increase in the supply as more retail developments are completed, which would certainly have an impact on the dynamics of the retail market in Qatar.

With regard to real estate development and despite that the Real Estate Development Law was considered a significant move into regulating the real estate market development we have yet seen full implementation of the law pending the executive regulations of the law to be issued. The initial reading to the law indicates that a further development in shaping and regulating the legal framework of real estate developments and developers in Qatar can be expected to be seen in respect of a strata model of ownership. The main principle of a strata management is the division of property into privately owned units and jointly owned common areas, which are managed by co-owners associations representing the collective interests of the owners. Whereas Articles 884 to 903 of the Civil Law generally regulate ownership of units and the management of common areas by a co-owners association, Articles 884 to 903 are not equivalent to a separate and fully implemented strata law. A regulatory framework for the management of developments would contribute to prevent, *inter alia*, abuses by developers where the management fees charged are used as a source of cash flow.

16 Law No. 22 of 2017.

Chapter 25

ROMANIA

Valentin Creața[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

Based on the Roman law system, Romanian law distinguishes between rights *in rem*, as rights over or in connection with real estate, and rights *in personam*, as personal rights on performance of obligations.

The ownership over real estate is a right *in rem* and grants its holder the full right to use and dispose of the real estate. The other rights *in rem* (i.e., superficies, usufruct, easements, *usus* and *habitatio*) grant their holders only part of the attributions of the full ownership.

The superficies right is of particular importance to investors and, starting with the New Civil Code (which entered into force as of 1 October 2011),[2] enjoys unitary regulation. The superficies right entitles its owner to erect and to own a building on a third party's land. The owner of the building obtains the right of use on the land. The superficies right can be obtained for free or for a fee and is available for maximum of 99 years, with the possibility to be extended repeatedly. The ownership may be public or private. The public ownership belongs solely to public entities (i.e., Romanian State, counties or localities) and operates on real estate regulated by law as being publicly owned. The private ownership may belong to public or private entities and operates on any other real estate than that which is subject to public ownership.

There are several forms of private ownership: (1) exclusive ownership – granting the free use and disposal of the real estate to a single entity; (2) co-ownership by share quotas – real estate owned by more entities on ownership quotas, usually as pro-rata shares; and (3) joint ownership – real estate owned by more entities without determining their quotas (usually in wedlock).

A recent institution under Romanian law is the fiduciary agreement,[3] which creates the possibility for any person to transfer rights (including ownership) to one or more fiduciaries (e.g., credit institutions, investment companies, management companies, insurance companies), to exercise full prerogatives of such rights, for a specific purpose and period (not exceeding 33 years), for the benefit of one or more beneficiaries (constitutor, fiduciary or third person).

1 Valentin Creața is a partner at Popovici Nițu Stoica & Asociații. The author would like to thank the real estate development team, including Andreea Grosu, Luiza Zamura and Geanina Popescu, for its valuable support.

2 Law No. 287/2009 on Civil Code.

3 The fiduciary institution is similar to trust under the Anglo-Saxon law system.

In Romania, there is no leasehold ownership. A lease is a right *in personam* and provides its holder only the personal right to use the property against the payment of rent during the contractual period.

ii Registration system

Romanian real estate is registered with the land registry operated by the National Agency for Cadastre and Land Registration. Land registry is publicly available and ownership information can be obtained by requesting a land book excerpt.

The land book excerpt consists of three parts: (1) real estate description (surface, location and use type; (2) ownership information (owner, title and relevant documents); and (3) encumbrances (e.g., mortgages, easements, interdictions and litigations).

The land registry is undergoing a process of modernisation, implementing an online system for accessing the necessary services. Currently, the land book excerpt may be obtained online and, in the future, all other services related to the ownership right (registration, dismemberment, consolidation, etc.) will be available online.

The registration of real estates with the land registry was given constitutive effect as of 1 October 2011. As a general rule, the rights *in rem* over real estate registered with the land book may only be transferred by registration with the land book, based on the valid title on the real estate. Likewise, rights *in rem* may be cancelled solely by removal from the land registry, based on their holder's written consent or a final judgment.

Such rule shall only be implemented after completing the cadastral measurement formalities within each territorial unit, envisaged for the years to come.

Until then, all formalities with the land book registry have only an opposable effect, so failure to register real estate operations with the land book registry does not affect their validity, but deprives the parties from legal protection against third parties who are not bound to observe such operations.

iii Choice of law

Real estate transactions have to observe certain rules to be effective in Romania, such as authentication of the transfer deed by notary public, registration with the land book registry, price payment in local currency (for legal persons) and fiscal certificate attached.

Generally, parties to a transaction on real estate in Romania are free to choose the law applicable to the contractual matters, to the extent that the chosen law does not prejudice the Romanian legal provisions that cannot be exempted. Should the parties fail to choose a governing law, the Romanian law (*lex rei sitae*) will apply.

The aforementioned also applies when the parties are citizens of a European Union Member State.[4]

4 Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I).

II OVERVIEW OF REAL ESTATE ACTIVITY

After an exceptional year in 2016, with a headline growth of 4.6 per cent, the Romanian economy followed the same path in 2017 and in the first quarter registered the highest percentage growth in the European Union[5] (private consumption remained the main driver of the growth).

The evolution of the real estate market is closely related to the economy. Consequently, during the first semester of 2017, approximately 30,000 square metres of modern shopping centres were delivered in the entire country. In Bucharest alone, the delivery of warehouse spaces stood at approximately 150,000 square metres and of office buildings at approximately 50,000 square metres.

In 2017, the retail market focused on two trends: retail parks in small cities and extension of existing spaces in large cities, Romania being one of the main destinations for international retailers to expand in Europe. 2016's goal of bringing new brands to Romania was maintained in 2017, with the main focus on the upper-middle income segment.

The office market remained very strong, with the Bucharest market registering leasing transactions of approximately 170,000 square metres in the first semester of 2017.[6]

During the first half of 2017, yields remained relatively unchanged from the previous year. The average transaction value doubled compared with the same period of 2016. Rent levels on the office and retail markets remained broadly unchanged, proving that the real estate market has reached a level of stability and maturity.

III FOREIGN INVESTMENT

As of 1 January 2014, all restrictions imposed by Romanian law on land ownership by foreign individuals and legal entities from EU Member States were removed. Moreover, land acquisition by non-EU nationals is permitted subject to reciprocity,[7] according to international treaties; however, non-EU nationals cannot acquire ownership of Romanian land in more favourable conditions than EU citizens.

Buildings are not subject to such restrictions and can be freely owned by foreign individuals and entities, to the extent that the relevant ownership is not also attached to some land quota.

It is common practice for foreign individuals and entities to indirectly acquire and hold real estate through special vehicles in the form of legal entities under Romanian company law.

Foreign investors benefit from national favourable treatment, have access to all sectors of the economy[8] and are granted important benefits, such as the full repatriation of capital and profits obtained in Romania, full protection against expropriation and nationalisation, and access to incentives and funds provided by EU and Romanian legislation.

5 Eurostat – flash estimate of GDP for the second quarter of 2017.

6 Report published by Colliers International Romania.

7 The reciprocity principle states that foreign nationals are subject to the same restrictions related to real estate acquisitions as applied to Romanian nationals by their own country.

8 As per the Doing Business Report published on national government website, the main investment opportunities and key sectors in Romania are: automotive and car component production, aerospace, wood industry, energy and renewable energy, IT&C, infrastructure, agriculture, food industry, pharmaceuticals and healthcare, chemicals, fast-moving consumer goods (FMCG), tourism, real estate and construction and natural resources.

In the context of land market liberalisation, a new regulation was enacted in April 2014[9] providing a pre-emption right in favour of co-owners, lessees, neighbouring owners (irrespective of their nationality) and the Romanian state, in this order, at equal price and in equal conditions, in case of selling agricultural lands outside locality borders.

Romania supports investments implementation throughout state aid schemes, stimulating growth and sustainable development. In 2014, a new state aid package[10] was adopted and it will be in force until 2020. Through this, Romania will benefit from approximately €43 billion of European funds.

IV STRUCTURING THE INVESTMENT

The acquisition of Romanian real estate is usually structured either as an asset deal (by which the real estate is purchased directly) or as share deal (by the acquisition of the shares of a Romanian company owning the targeted properties).

i Asset deal

The asset deal investment may be implemented either by simple acquisition of assets or as transfer of business (ongoing concern transfer). In this later case, the acquisition includes not only the property, but also the business attached to respective asset (e.g., movable and immovable assets, agreements, employees, trademarks).

Through direct transfer of assets from the owner to the investor, the impact of the historical problems related to the title or to the vendor is diminished or even excluded.

This way, the acquirer:

a does not take over the fiscal exposures of the current owner and the obligations from the agreements that are not transferred to the investor (outside the transfer of business);

b secures a transfer of ownership in good faith and subject only to the land book registration rules;

c may register higher expenses with the fiscal depreciation than the the vendor (as existing owner) and, to this end, the acquirer would register a reduced taxable profit and, implicitly, the income tax is lower; and

d may maintain certain authorisations (attached to the transferred assets) that do not lose their validity (e.g., fire-fighting permits). On the other hand, the other authorisations (e.g., operating permits) have to be obtained again by the investor.

The taxes attached to asset deal investments are higher than for share deals. The registration tax and the notary public's fees for contract's authentication amount up to 1 per cent of the transaction price.

In case of business transfer, this percentage would apply to the entire transaction price stipulated under the authenticated agreement. The taxes may be lowered by splitting the transaction documents into (1) a framework agreement (non-authenticated) establishing the

9 Law No. 17/2014 on certain measures to regulate the sale and purchase of agricultural lands located outside the country.

10 Government Decision No. 334/2014 on state aid granting for investments stimulating the creation of minimum 10 new jobs (maximum scheme budget approximately €600 million) and Government Decision No. 807/2014 on state aid granting for investments of minimum 44 million leu in fixed assets (maximum scheme budget approximately €600 million).

structure of the investment; and, separately, (2) an authenticated agreement having as subject matter only the immovable assets, so the taxes are applied only to the price agreed for the immovable assets.

The existing guarantees over the transaction and the assets provided by the original contractors remain in the vendor's patrimony (except for the legal guarantees), and the acquirer shall benefit only the guarantees provided by the vendor under the sale-purchase agreement (eviction and defects).

If the vendor is only a project company, there is a risk that it will no longer conduct business after the assets' transfer and it will be dissolved. In this case, it is recommended to cover the risk through independent contractual guarantees provided by mother companies or by title insurance.

ii Share deal

The share deal consists of transferring the entity (usually a company) currently owning the real estate, by transferring the shares in the respective entity.

The most commonly used corporate structures are the joint stock company and the limited liability company:

a The joint stock company is the most complex corporate structure, composed of a minimum of two shareholders, with a minimum share capital of €25,000, in Romanian lei equivalent, and complex management rules. This is the entity suited for the investors interested in capital-driven structures and the only type of company to be listed with the stock exchange.

b The limited liability company is a more simple corporate structure, which may be incorporated even by a single shareholder, with a minimum value of the share capital of 200 lei and more simple management rules. It can have maximum of 50 shareholders.

In both corporate structures the company's obligations are guaranteed with the company's patrimony, and the shareholders are liable only to the limit of their contribution to the share capital.

Another possible investment structure for an asset deal or share deal is the joint venture agreement. The participants bring together funds, assets or both, as contribution for developing a project, the ownership on the assets remaining in the participants' patrimony. The participants establish their rights and obligations in the agreement and appoint one of them as manager, representing the joint venture.

The joint venture does not imply the incorporation of a separate entity by its partners, so all the obligations shall be guaranteed by the participants with their contributions and their patrimony.

Although the law requires that only the asset deals should be authenticated by the notary public so as to be valid, having an agreement concluded in authenticated form confers advantages on the investor when claiming the enforcement of contractual obligations.

In some cases, various formalities should be fulfilled for a valid transaction. For example, approvals for transferring special regime real estate (historical or archaeological monuments, protected areas), approvals from guarantors or persons holding specific rights on an asset (financial institutions, other creditors) and Competition Council clearance (if the transaction meets the Competition Law conditions on minimum turnover, change of control, etc.).

The investment structure should be carefully chosen, with particular attention to the ownership history (the remnants of the communist regime still affecting the ownership titles and the owners' rights and obligations), the current status of the asset, tax regime and, most importantly, the investors' profile, protection and expectations.

V REAL ESTATE OWNERSHIP

i Planning

Facilities may be developed on certain land provided that parameters established under the applicable territory planning and urbanism documentations are observed.

The urbanism documentation represents the outcome of land-plot planning (reflecting localities' organisation, constructible areas and building conditions) and provides general information regarding the possibilities to erect buildings on a specific land.[11]

After confirmation that a building may be developed, the investor should get information on the land plot scope of use (economic regime) and on construction conditions (technical regime), based on the urbanism certificate.

The urbanism certificate also provides information on the approvals and permits necessary for a building permit. The urbanism certificate does not grant the right to build, this being established only by the building permit issued based on the formalities required under the urbanism certificate, the technical documentation of the building and the legal requirements.

ii Environment

Irrespective of having a facility under development or a standing investment, the owner (including contractors, agents, tenants, employees) is bound to observe the environmental regulations.

These apply to any type of pollution (noise, land, water and air pollution, waste disposal and evacuation) and are related to all operational permits necessary for the development or exploitation of all facilities (e.g., fire-fighting, operating, environmental, health and security work, civil protection).

A particularity for Romania (and in many other countries of the former Communist Bloc) is that many developments, especially brownfields, generate a false image of clean projects, while they may hide dangerous or prohibited materials that are covered by the evolution of the land plots or buildings and are difficult to detect. To this end, it is advisable that the investors retain specialised consultants for the environmental aspects of the development.

The real estate beneficiaries bear the liability for ensuring compliance with the environment protection laws, which, depending on the outcome of the breach, may be administrative, civil or criminal liability.

11 Law No. 350/2001 on land planning and urbanism.

iii Fire safety requirements

Certain constructions[12] (e.g., high and very high buildings, office and commercial buildings exceeding 600 square metres) are subject to fire safety authorisation. The authorisation has to be obtained prior to the commencement of any construction, and the person bound to obtain it is either the investor or the beneficiary of the investment.

The fire safety authorisation is issued after submitting technical documentation (containing fire safety scenarios, fire safety notices, evacuation plans, etc.) and is valid as long as the conditions met at its issuance are fulfilled and no changes are made to the building. The lack of authorisation triggers administrative fines, but in case of major breach of fire safety requirements (irrespective of the existence of the authorisation) the authorities may stop the building operation. Moreover, criminal liability may be a factor if a fire causes bodily injury or death.

iv Completion of the project

Romanian law regulates the reception of construction works, certifying the fulfilment of the construction works and the construction takeover by the investor.

The reception regulations were significantly amended in 2017,[13] implementing new elements such as partial reception (which allows the building reception on execution stages, before its completion), new structure of the reception committee (mandatorily involving multiple local authorities), new force of the reception committee's decision (which is now compulsory for the investor) and simplification of the reception options (the reception may only be admitted or rejected).

v Tax

All asset owners owe local taxes on land and buildings. Exemptions may be available if the buildings serve a public or social interest.

The land tax is determined on: (1) surface; (2) location (e.g., inside or outside the locality's borders); and (3) use category (e.g., constructions, agricultural), as all such are established by the local authorities.

As regards the buildings, the tax is determined depending on the building category, namely 0.08–0.2 per cent of the fiscal value of the residential buildings, 0.2–1.3 per cent on non-residential buildings and 0.4 per cent on agricultural buildings. The fiscal value of the buildings has to be updated every three years by valuation, for buildings that have not been acquired during this period. Otherwise, the applicable quota of local tax is increased to 5 per cent.

In case of transfers, taxes vary depending on the transaction structure. In a share deal, the stake seller owes the corporate or personal income tax, which is of 16 per cent[14] of the capital gain (reduced to zero if the shareholder is a company owning more than 10 per cent

12 Government Decision No. 571/2016 for approval of the categories of buildings and fittings out subject to fire safety approval or authorisation.

13 Government Decision No. 343/2017 regarding the approval of the regulation for the reception of construction works and related installations.

14 The microenterprise taxation regime applicable for certain companies has not been considered.

of the shares for minimum one year, subject to additional conditions). For foreign nationals, additional benefits may be available under the conventions for the avoidance of double taxation.

In asset deals, 16 per cent corporate income tax[15] applies on the profit, except for the case of natural persons, for which the tax varies between 1 per cent and 3 per cent of the price.

A reverse taxation mechanism is applicable to constructions and lands whose transfer is subject to VAT, which applies if both seller and buyer are registered for VAT purposes in Romania. Otherwise, the normal VAT system applies.

If the land is not for construction purposes, the transfer is VAT exempt (with no deduction right). VAT exemptions also apply to transfer of buildings, except for the new buildings.

For all real-estate transactions where an exemption applies, the seller can opt to levy VAT, based on prior notification of the tax authorities.

vi Finance and security

The acquisition of real estate either through asset deals or share deals is most commonly financed by banks. The foremost securities are the mortgages, which may be established over immovable assets, owner's shares and certain present and future rights attached to the property (e.g., rent, indemnities, bank accounts).

The mortgages established over the immovable assets are valid if the relevant agreement is concluded in authenticated form before the public notary and become effective as of their registration with the land book registry.

Regularly, such mortgages that totally or partially encumber the real estate go along with interdictions to transfer the asset, to build or to implement any other operation that might affect the property (e.g., partitioning, consolidation, lease, easements).

The mortgage agreement validly concluded and registered with the land book registry or the Electronic Archive for Security Interests in Movable Property represents enforceable title. Thus, the enforcement procedure of the corresponding security is simplified and the court intervention for establishing the enforceability of a mortgage is not necessary.

VI LEASES OF BUSINESS PREMISES

i Features of lease agreements

The lease of all premises is governed by the New Civil Code.

The lease agreement signed by the parties and registered with the fiscal authorities or authenticated by a notary public represents enforceable title as regards: (1) the payment of rent; and (2) the obligation to return the premises (upon the term expiry or following the expiry of a notice period), respectively the evacuation of the tenant. The landlord is, thus, exempted from additional formalities and expenses and may initiate directly the enforcement procedure for failure by the tenant to observe such obligations.

ii Duration and the right of renewal

The lease period may be determined by the parties. Should the parties not provide the lease term, the lease is considered concluded for one year. In all cases, the lease agreement may be

15 A microenterprise taxation regime applicable for certain companies has not been considered.

concluded for a maximum of 49 years. The longer lease term shall be *de jure* reduced to 49 years. The lease agreement ceases on the expiry date of the lease term, when determined, or upon the request of any party through unilateral termination, with the observance of a notice period, in case the duration was not determined.

Romanian law provides the prolongation by tacit renewal: if the tenant continues to execute the lease agreement following the term expiry without any opposition of the landlord, a new lease is considered to be concluded, under the same conditions, including the guarantees. However, the new lease term shall be undetermined.

As standard practice, the parties include renewal provisions in the lease agreements, not leaving such aspects to fall under the legal standard renewal clause.

iii Repair works and related costs

As general rule, in the absence of an alternative parties' agreement, regular repairs resulting from normal wear and tear are the tenant's responsibility and repairs relating to the building's structure and common areas are the landlord's responsibility.

Insurance of the building is usually the landlord's responsibility, but a share of its value may be included in the service charges owed by the tenant. The tenant may be obligated to conclude certain insurances related to the rented space and its activity (e.g., civil liability insurance against third party claims, insurance against damage and loss of furniture, equipment).

iv Service charge

Usually, in addition to rent and other costs, a tenant of commercial premises (e.g., office, retail, logistic) may be obligated to pay service charges as part of the aggregate expenditures incurred by the landlord in respect of all the expenses regarding the building (e.g., utilities for common areas, managements fees, insurance premiums).

v Subletting and assignment of rights

According to the New Civil Code, the tenant is entitled to sublease the premises or to assign its rights on the premises, if that is not expressly forbidden in the agreement.

Similarly, unless otherwise stipulated in the agreement, the lessor is entitled to assign its rights from the lease agreement without the consent of the tenant.

vi The rent

The rent may be freely established by the parties, either globally or fixed on time units. No rent control exists in the private sector. Should the parties fail to establish the payment terms, it shall be paid: (1) in advance, if the lease term is under one month; (2) on the first business day of each month, if the lease term is between one month and one year; or (3) on the first business day of each quarter, if the lease term is at least one year.

The rent is generally calculated on the basis of the premises' area and is subject to VAT payment in accordance with Romanian tax legislation.

As standard practice for the lease of premises in commercial centres, the financial obligations of the tenant comprise: (1) minimum guaranteed rent established in €/m2; (2) turnover rent established as percentage for certain period (usually per year) of the net total turnover achieved by the tenant in connection with the premises, which is payable if it is higher than the prepaid minimum guaranteed rent; and (3) operating costs including common operating costs, marketing costs and own operating costs (utilities), measured either by independent consumption metres or by engineered value.

Payments are usually designated in euros and payable in Romanian lei. Fixed rent is subject to annual indexation. In addition, parties may agree upon increase of the rent by using different calculation methods (e.g., average level of the rents in the commercial centre or collected from similar tenants, results of the commercial centre or of the tenant's activity in the premises or the economic evolution of the geographic area or the country).

vii Tenant's liability

The leases for commercial premises are usually executed in favour of the landlord (excepting the cases of anchor tenants, with a strong market position and negotiation power) and, therefore, all matters of the tenant's liability and financial obligations are strictly regulated under such agreements.

Regularly, the tenant is financial liable for early termination of the agreement (save for the termination by landlord's fault), being compelled to pay the rent and related costs calculated until the end of the lease period or until the premises are leased to a new tenant at similar rent level.

Usually, the tenant obtains at its own cost the permits and authorisations necessary for the premises' use and related renovation works. Such tenant's renovation works are usually not to be reimbursed to the tenant, except for the lease termination by landlord's fault.

Generally, the tenant assumes any risk of damage caused in or to the premises and is liable for the alteration and degradation of the premises, including in the case of fire, to the extent he or she cannot prove the force majeure or fortuity cases.

viii Security of tenure

There are no mandatory provisions regarding the guarantees the tenant must provide to the landlord in order to secure the tenure.

In practice, the tenant provides either a deposit or a letter of bank guarantee, valid throughout the lease period, for a value generally amounting to three months' rent and operating costs.

The parties may also agree for the tenant to provide a parent company guarantee (e.g., corporate guarantee, comfort letter), unconditionally securing the performance of the tenant's obligations.

VII DEVELOPMENTS IN PRACTICE

i The inflation rate

Against a rising annual inflation rate, the acceleration of annual dynamics of GDP and risks concerning the economic growth in the euro area and globally, the board of the National Bank of Romania has maintained a monetary policy rate at the same record low level of 1.75 per cent since 2015. Thus, Romanian leu-denominated loan interest rates are at historic levels that have generated increments of up to 61.4 per cent to Romanian leu loans.

ii Law No. 77/2016

One of the main changes that took place in 2016 was the entering into force of Law No. 77/2016 on the discharge of mortgage-backed debts through transfer of title over immovable property. This law grants the consumers in a non-performing loan under €250,000 the possibility to give back the residential property to the bank if they cannot return the loan, but only if the impossibility of repaying the loan is due to unpredictable causes (e.g., financial crisis, exchange rate).

Banks have been forced to revise their strategies in order to combat the possible negative effects of consumers deciding to benefit from the provisions of the Law. For example, the initial contribution of the borrower in a normal mortgage agreement has been increased from 15 per cent up to 25–35 per cent, depending on the bank.

As expected, since the Law took effect, about 7,000 requests have been registered to give properties to banks in order to close debts, out of which 4,000 have been disputed in court. This trend was diminished by a Constitutional Court Decision[16] stating that not all non-performing loans are subject to such measure. In this regard, the applicability of the law has to be investigated from case to case. This decision has also had an impact on the banking conditions for granting a loan, because some of the banks have revised the conditions for the initial contribution mentioned above, again applying a limit of only 15 per cent.

Although banks have warned that Law No. 77/2016 will significantly affect real estate financing, recent statistics show that the value of real estate loans in Romanian leu granted by the banks in the first nine months of 2017 have increased by 0.7 billion lei[17] compared to the value of loans granted in the same period of the past year.

iii The 'First Home' governmental programme

Launched in 2009, the 'First Home' governmental programme represented a very important financing source for residential acquisitions. Between 2009 and the end of September 2016, the financing granted with guarantees amounted to approximately 34 billion lei.[18]

Although it was a very effective measure during the economic recession, it seems that the programme is currently following a deceleration strategy.[19] In this regard, in 2016, the programme benefited from a guarantee limit of 2.9 billion lei; in 2017 the figure was 2.5 billion lei; and a limit of 2 billion lei is expected in 2018. If the current strategy is maintained, it appears that the programme will have an increasingly smaller budget until it is taken off the market.

iv The new Fiscal Code

The real estate market continues to be subject to legal changes that might have significant consequences.

The Fiscal Code applicable since 1 January 2016 reduced the standard VAT rate from 24 per cent to 20 per cent for 2016 and, respectively, to 19 per cent for 2017. A previously announced reduction of VAT rate to 18 per cent from 2018 is no longer being applied.

16 Decision No. 623/2016 of the Constitutional Court.

17 Statistics performed by the National Bank of Romania.

18 Statistics presented by the Romanian government.

19 On 29 November 2016, the Romanian government signed the deceleration strategy of the 'First Home' Programme for 2017–2020.

A significant fiscal measure applicable from 2018 is the VAT split payment, which implies the operation of a separate bank account for VAT payment, in all transactions subject to VAT.

The measure will be applicable in 2018 to the public companies and companies that have contractual relations with the state and, if the system proves effective, the measure will be extended to all VAT-taxable persons in 2019.

Recently, the Romanian parliament initiated a procedure to change this measure, prior to its application, so as to maintain the VAT split payment solely for: (1) companies under insolvency or insolvency prevention procedures; or (2) companies with VAT debts older than 60 days and exceeding certain value thresholds. Such amendments have been enacted and are applicable as of 1 January 2018.

v Other relevant aspects

A new package of laws on public procurement was adopted in 2016, initiating changes aimed to simplify the process and to create better communication between the public and private sector and more transparency.

The national strategy[20] for public procurement contains the obligation to implement FIDIC standards within the public procurement agreements in order to unify the contractual arrangements, but it has recently been announced that such agreements may differ from FIDIC standards, so we may expect some changes in this field.

VIII OUTLOOK AND CONCLUSIONS

Romania was predicted to have the highest economic growth in Europe in 2017 (together with Ireland), growing by around 5.5 per cent.[21] Over the next two years, the economy is expected to grow slightly, with rates of 4.2 per cent in 2018 and 3.6 per cent in 2019.

Consequently, the economic grounds for business development are promising and Romanian real estate offers interesting opportunities in all business sectors.

The Romanian real estate market is still under reshaping process given the adoption of the New Civil Code, as the corresponding legal practice and case law are under a settlement process. The ownership reinstatement process triggered to cure the state's abusive actions under the communism period appears to be reaching its end, as the specific terms granted under the restitution laws for filing restitution claims are overdue.

Although the legal system may raise concerns about stability perspectives and the duration of court proceedings is rather long, significant steps have been made in fighting corruption, with Romania receiving positive assessments in this respect.

20 The adoption of such strategy was assumed within the Romanian Partnership Agreement for the 2014–2020 Programming Period.

21 International Monetary Fund latest World Economic Outlook, October 2017.

Chapter 26

RUSSIA

Sergey Kolobov[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

Under Russian law there are two main legal interests in real property:

a ownership: full title allowing possession, use and disposal of the property, including leasing it out to tenants. It is in some respects similar to freehold, although Russian law recognises separate ownership of land and of the buildings and other fixtures erected on land. Ownership rights to land extend to the surface (soil) layer of the land plot as well as to water (with some restrictions) and plants on the land plot. The subsoil is entirely state-owned; and

b lease: an interest allowing possession and use of the property for a specified or an indefinite term.

The most common ways to acquire ownership rights to real property are as follows:

a sale and purchase, exchange or gift;

b privatisation of state-owned or municipal-owned real property (especially land plots);

c by operation of law (e.g., if a legal entity is going through a reorganisation, the reorganised entity is deemed to have acquired ownership rights to the relevant real property by operation of law);

d development of real property; and

e inheritance.

Real property may be co-owned. There are two types of co-ownership: shared ownership (where the shares of co-owners are determined) and joint ownership (where the shares of co-owners are not determined). Shared ownership is a default option for co-owning real property unless the law provides otherwise (e.g., community property (i.e., property owned in common by husband and wife) is deemed to be a joint ownership) or it is not feasible to determine the shares of the co-owners.

The most common shared ownership is co-owners having shared ownership of the common areas in trade centres, shopping malls and office buildings. Usually, such co-owners have also been co-investors in the development of the relevant building. Co-owners may conclude a co-ownership agreement and govern the manner of use, maintenance and disposal of the co-owned real property.

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Russian law also recognises a hereditary land plot right, which is in many respects similar to absolute ownership but may be acquired only through inheritance. Previously this right was granted only to individuals, and state and municipal authorities have now ceased to grant such a right.

Certain rights to property, which are at present primarily reserved for state institutions (such as 'permanent use'), still exist. These rights are no longer granted to individuals and private entities, and are non-transferable.

In Russia, it is not possible to separate the legal interest in property from the beneficial interest.

ii System of registration

The ownership right and other rights *in rem* over real estate, most encumbrances and restrictions of such rights (such as long-term leases, mortgages and liens), and their accrual, transfer and termination, are subject to state registration in the Unified State Register of Real Estate. Those rights and encumbrances are deemed valid and effective once registered.

Most agreements under which rights *in rem* and registrable encumbrances arise are not subject to state registration (e.g., sale and purchase agreements, mortgages) and become valid and enforceable once executed by the parties. However, the law still requires registration of long-term lease agreements, as well as registration of encumbrances established by those agreements, in the Unified State Register of Real Estate. As a general rule, if a long-term lease agreement is not registered, it is deemed not to have been concluded.

The Unified State Register of Real Estate is, for the most part, a matter of public record, and any person may request an extract from it in relation to a particular property. The extract will contain a description of the property (type, address, area) and set out the type of registered rights to the property, the holder of the rights, as well as encumbrances and restrictions of the registered rights as at the date of the extract.

It should be noted that starting from 1 January 2017 the Unified State Register of Real Estate was merged with the State Real Estate Cadastre. Prior to this, before the merger, a piece of property had to be registered in the State Real Estate Cadastre to become real estate as a legal matter, then title to it was registered in the Unified State Register of Real Estate. Now both registrations can be done simultaneously in a single state register – the Unified State Register of Real Estate, which simplifies the overall procedure for registration of a real property and title to it.

iii Choice of law

Russian law provides for a strict rule that any transaction involving real property is subject to Russian law, effectively applying the principle of *lex rei sitae*. This means that any agreement in relation to the disposal of real property located in Russia (e.g., lease agreement, mortgage agreement, agreement establishing an easement or any other agreement under which real property located in Russia is encumbered) must be governed by Russian law.

However, it is possible for the parties to enter into a framework agreement in relation to real property that provides for certain general obligations of the parties, covenants, warranties and representations, and to choose the law applicable to this framework agreement. Usually a framework agreement is used in conjunction with a Russian law-governed agreement in relation to real property that regulates the actual transfer or encumbrance of real property.

II OVERVIEW OF REAL ESTATE ACTIVITY

In the boom years, Russia was one of Europe's largest property markets, with investment volumes of US$8 billion–US$10 billion annually. The figure briefly decreased during the 2008–2009 financial crisis.

However, the downward trend on the property market that began in 2014 continued in early 2016, in sync with the political challenges Russia is facing because of continuing Western sanctions, and low oil prices, which brought about the weakening of the Russian currency.

In 2016, the Russian economy, supported by oil price growth and rouble appreciation, showed the first signs of stabilisation: it demonstrated the lowest inflation rate ever – 5.38 per cent, while in 2015 this figure amounted to 12.91 per cent. The GDP expanded by 0.3 per cent in the fourth quarter of 2016 (this was the first GDP growth since the fourth quarter of 2014). Encouraged by the improving macroeconomic environment, investors' activity in the real estate market escalated: the total investment amount reached US$4.17 billion, which is 40 per cent higher than the result for 2015.[2]

Almost 40 per cent of investments in real estate were made by state-owned companies and state authorities, while there were no such deals in 2015. Examples of the largest deals of this kind include:

a the Evolution Tower sale to Transneft;

b transfer of President Plaza and Eurasia to Sberbank and VTB respectively as debt repayments under loan agreements; and

c acquisition of the part of Oko tower by the Moscow city administration.

The office segment remained dominant in terms of transaction volumes, comprising 72 per cent of the total invested amount. It is also worth noting that the average transaction size increased to US$78.6 million, compared with US$58 million in 2015.[3] At the same time the share of foreign capital in the real estate investments fell to a record low of 2 per cent.[4]

In the first half of 2017, the Russian economy continued to demonstrate an enhancing growth trend, which boosted the recovery of interest in real estate, including among foreign investors. Investments in the real estate market for two quarters of 2017 reached US$2.2 billion and were expected to be US$4.5 billion by the end of 2017. Retail and office sectors were the most active, accounting for 41 per cent and 32 per cent of the total amount of the investments respectively, with the largest deals being sale of Leto Shopping Mall to Roseurodevelopment and Goldman Sachs International in St. Petersburg, and sale of Vozdvizhenka Business Centre to Fosun Group and Avica Management Company in Moscow. Moscow remained the most attractive for investors in Russia, with a 73 per cent share of the total volume of the investments. The share of St. Petersburg grew to 18 per cent. Foreign investors increased their share to 21 per cent.[5]

2 Colliers.

3 Colliers.

4 Cushman & Wakefield.

5 Jones Lang LaSalle.

III FOREIGN INVESTMENT

Subject to the following restrictions, real property can be purchased or leased by foreign individuals and companies for their own use or as an investment:

a foreign individuals and entities are not allowed to own land in areas adjoining the borders of Russia or land located within the boundaries of a seaport; and

b foreign individuals and entities, as well as Russian entities with over 50 per cent foreign participation, may not own agricultural land (which is a specific category of land under Russian law).

There are no specific restrictions that apply to the lease of land, or the ownership or lease of buildings and facilities by foreign nationals.

IV STRUCTURING THE INVESTMENT

i Acquisition structures

There are two main structures for the acquisition of real property: asset purchase (acquisition of real property directly from its owner) or share purchase (acquisition of a holding company that owns relevant real property).

Asset purchase

Where a deal is structured as an asset transfer, the target's liabilities, including tax liabilities and penalties, should not (subject to careful structuring) transfer to the purchaser.

An asset purchase is not, however, a perfect solution for the following reasons:

a there remains a risk that the Russian tax authorities could recharacterise the asset transfer as a 'sale of an enterprise' under which historic liabilities would be treated as transferring to the purchaser; and

b the authorities may attempt to establish that an asset transfer constitutes a fraud against creditors if it is proved that it was designed to evade historic liabilities.

In addition to these risks described, the key disadvantages of a sale of assets are as follows:

a administratively, they are more cumbersome than an acquisition of shares;

b the acquisition may require obtaining new licences and permits, novation or assignment of contracts; and

c the acquisition may lead to Russian VAT being payable.

A typical sale and purchase transaction is a two-stage process involving the execution of a sale and purchase agreement and registration of the transfer of title in the Unified State Register of Real Estate. The sale and purchase agreement must be a single written document.

The handover of the property is effected by completing a document that formally conveys the property from the seller to the buyer (an act of transfer and acceptance).

As a general rule, if a building or other immovable facility and the underlying land are owned by the same person, a sale of the building without the underlying land (and vice versa) is not allowed. If the land is owned by someone other than the owner of the building, the building can still be sold, and the new owner will enjoy the same rights to use the respective part of the land plot underlying the building as the previous owner of the building.

Share purchase

Share purchases are still a very popular way to acquire real property in Russia. The major risk of a share acquisition is, of course, that a buyer will also assume all of the target's existing liabilities (subject to any contractual apportionment and post-acquisition risk mitigation strategies). This means that thorough due diligence of the historic activities of the target are crucial.

There are, nevertheless, numerous advantages in a share purchase structure, chief among which are avoiding the need to reapply for licences and permits, a less complex and burdensome acquisition process, no Russian VAT and the avoidance of business interruption.

ii Acquisition vehicle

If the target company does not have a dedicated offshore holding company, it may be advisable to set up a holding company to make the acquisition or, in the case of an asset transfer, to create an offshore holding company with a wholly owned Russian subsidiary (the latter being the recipient of the transferred assets). The choice of jurisdiction will largely be driven by tax issues and corporate considerations.

iii Tax implications of acquiring an interest in property

Generally, commercial property transactions are subject to VAT (the standard VAT rate is 18 per cent). Currently, the sale of land and residential property transactions are not subject to VAT.

The sale of shares of a company by its foreign parent entity is subject to withholding tax in Russia if the assets of this company directly or indirectly consist of more than 50 per cent of real estate located in Russia and of derivative financial instruments from these shares, with the exception of shares in circulation. In certain cases, the sale of these shares may be exempt from Russian withholding tax based on relevant double tax treaty provisions.

V REAL ESTATE OWNERSHIP

i Planning

Planning and zoning in general are regulated by the Land Code and the Urban Planning Code, although the more technical aspects are set forth in regional and municipal legislation.

The Land Code and the Urban Planning Code operate with two main terms related to planning and zoning: the land category of the land plot; and the permitted use of the land plot. These terms determine how a particular land plot may be used.

There are seven land categories that attribute a land plot for certain general use (e.g., agricultural land, industrial land, urban land). Permitted use of the land plot is assigned to a particular land plot in accordance with zoning plans approved at each level, starting from the general zoning plan of Russia and ending with a zoning plan of a particular land plot. In comparison with the land category, the permitted use of the land plot is much more specific and determines what kind of building, structure or fixture may be erected on the land plot, or what activity may be conducted on the land plot (e.g., whether a land plot may be used for growing crops or for the development of a trade centre).

If a land category or permitted use (or both) prohibit a party from developing the relevant land plot, such a party must apply to the relevant authorities for a change of land category or permitted use; otherwise, the party will not be granted the appropriate construction permit.

ii Environment

As the contamination or misuse of real property is a matter of public concern, the relevant authority may conduct an inspection of the property and issue a clean-up order to the party responsible for the contamination or misuse. Normally, the liable party would be an owner or a tenant. Russian law also provides that if the owner of the land plot uses it in gross violation of its permitted use, the state authorities may confiscate the land plot (with compensation of its value to the owner).

The party responsible for contamination or misuse may also be subject to civil liability for damages caused to third parties.

iii Tax

Property tax

Russian companies are liable to pay property tax on the average annual net book value (or in certain cases the cadastre value) of the fixed assets on their balance sheet.

Foreign companies with a permanent establishment in Russia are subject to tax on immovable and movable fixed assets attributable to such an establishment. Foreign companies without a permanent establishment in Russia are subject to property tax on immovable property only.

Land is exempt from property tax and may be subject to a separate land tax.

The standard property tax rate is 2.2 per cent; special rates apply to property taxable on its cadastre value. Regional authorities may reduce the tax rate or, in some cases, provide a full exemption for all or certain categories of taxpayers, or based on the type of property.

Land tax

Land tax is payable by landowners at a rate determined by the municipal authorities. Land tax is assessed on the cadastre value of the land, which used to be substantially lower than its actual market value; however, recently this difference has decreased or even been eliminated.

Land tax rates may not exceed 0.3 per cent of the cadastre value of agricultural and residential land. With respect to other land plots, the maximum rate is 1.5 per cent of the cadastre value.

The Russian Tax Code permits municipal authorities to establish tax incentives for certain categories of taxpayers.

Businesses leasing land are not subject to land tax. Instead, they are liable for the land lease payments established by federal, regional or local authorities, or other landowners.

iv Finance and security

Usually, financing for the acquisition or development of real property is provided by banks. The most common security in relation to real property is a mortgage, which may be established over real property, lease rights and certain rights to property that are at present primarily reserved for state institutions.

A mortgage as an encumbrance becomes effective upon its state registration and, in the absence of such a registration, is considered to be null and void. The parties may enforce a mortgage without recourse to the courts (unless a limited number of exceptions apply).

The enforcement options for mortgagees include a public sale and taking possession of the secured asset (this option is not available if the mortgage is granted by an individual).

Where a land plot is mortgaged, all buildings and structures erected or to be erected on the land plot and owned by the mortgagor will be mortgaged by operation of law in favour of the mortgagee. Similarly, if a building or structure is mortgaged, the underlying land plot (if owned by the mortgagor) will be automatically mortgaged by operation of law in favour of the mortgagee.

VI LEASES OF BUSINESS PREMISES

Leases can be granted for an indefinite period (terminable by either party on three months' notice) or for a specified (fixed) term. A fixed-term lease can be long-term (i.e., one year or longer) or short-term (i.e., less than one year). Commercial leases are commonly long-term (five to 10 years). In almost all parts of Russia, the maximum lease term for state-owned land is 49 years.

As noted above, long-term lease agreements must be registered with the state to be effective. Short-term lease agreements and lease agreements for an indefinite term do not need to be registered. However, following liberalisation of court practice, a long-term lease that has not been registered may still be considered effective if the relevant agreement contains all material terms and conditions, and both parties have been performing their obligations under the lease (using leased real estate, paying rent, etc.).

Commercial leases are treated very much as a matter of private concern, with a limited number of mandatory rules and restrictions. While most of Russia's land is still state or municipally owned, commercial property is predominantly privately held. Accordingly, commercial lease terms tend to deviate from the default statutory position of equal treatment of the parties, and to favour the landlord or the tenant depending on their respective economic strength and negotiation leverage and the market situation in the relevant location. Before 2014, the lease market in developed regions of Russia, such as Moscow, has been heavily in favour of landlords, and leases have therefore tended to benefit the landlord (e.g., landlords having the right to terminate without recourse to the court for the most minor breaches by the tenant, with no corresponding rights for the tenant). However, as a result of the continuing economic downturn, the position of landlords has weakened, and tenants have increased their negotiating power in these regions.

Under the general rules governing leases, the tenant has a right of first refusal to renew the lease on its expiration, unless the agreement provides otherwise, but the parties are free to alter the terms and conditions of the new lease. If the tenant continues to use the property after the lease has expired and the landlord does not object, the lease is deemed to be renewed on the same terms and conditions as the old lease for an indefinite period. As such, the new lease is therefore subject to termination by either party upon three months' notice.

In the case of state or municipally owned land, subject to certain exceptions, the tenant has a statutory pre-emptive right to purchase the land plot if it is put up for sale, though in very limited circumstances. Where land is privately held, a tenant also has a statutory pre-emptive right to purchase the land plot if it is put up for sale, provided that the tenant owns a building or facility located on the leased land plot. Where the tenant does not own such a building or facility, the issue will be determined by the terms of the lease as negotiated between the parties.

In the event that the owner sells the leased real estate, the lease survives in full. The new owner assumes the rights and obligations of the landlord by virtue of law.

Proprietors of buildings or other immovable facilities that are situated on a land plot owned by another person are entitled by statute to rights of use as regards the land located underneath such buildings or facilities. If the land in question is state or municipally owned, the owner of the buildings or facilities is entitled to either lease or privatise (purchase) the land (effectively, 'the land follows the building').

As a general rule, the assignment, subleasing or mortgage of land leased by the tenant does not require the landlord's consent, unless otherwise stated in the lease agreement. Leases of state and municipal land concluded for a term of over five years cannot, as a matter of law, require the landlord's consent for their assignment, sublease or mortgage. Conversely, the assignment, sublease or mortgage of real estate other than land is subject to the consent of the landlord unless the lease provides explicitly that consent is not required. Such consent may be given directly in the lease agreement.

Most of the commercial leases contain rent indexation provisions. Depending on the negotiating leverage of the tenant, rent may be increased automatically each year in line with inflation or in line with inflation plus another index (e.g., LIBOR or by a fixed percentage). The landlord may review the rent no more than once a year.

VII DEVELOPMENTS IN PRACTICE

i Forward agreements

Recent court practice and amendments to the law have introduced a new concept of forward agreements, which may be entered into in relation to future real estate (either existing but not yet acquired by a party, or yet to be constructed). Currently it is possible to enter into forward leases, forward mortgages and forward sale and purchase agreements. In each case, the agreement must contain a detailed description of the future real estate to be encumbered or transferred.

This new concept allows developers and investors to form a pool of anchor tenants, obtain financing from banks by mortgaging the future building and sell the building on to third parties before it is fully constructed.

ii Registration formalities

In most instances, a real property agreement is valid and enforceable once executed by the parties. However, to transfer a title or establish an encumbrance, the parties still must register the transfer or encumbrance.

As previously mentioned, following recent changes in court practice, a long-term lease that has not been registered may still be considered effective if the relevant agreement contains all material terms and conditions, and both parties have been performing their obligations under the lease (using leased real estate, paying rent, etc.).

Despite the fact that the courts have applied the above rule only to the registration of long-term leases, the same logic may be applied to other registrable real estate agreements (real estate trust management agreement and agreement on shared participation in housing construction).

This position is further strengthened by the entry into force of amendments to the Civil Code on 8 March 2015, whereunder a party that accepted full or partial performance of a contract, or otherwise affirmed it, may not claim in court that it was not concluded, if such a claim were to contravene the principle of good faith. In other words, after performing or accepting performance of a lease, a party is estopped from claiming it was not concluded through lack of state registration.

iii Lease of state or municipal land for construction purposes

Major amendments to the Land Code became effective on 1 March 2015. Their purpose is to adjust the Land Code to the realities of the current real estate market, and to streamline the procedures for granting leases and privatising state-owned or municipal-owned land plots for all intents and purposes, including construction. Importantly, construction lease terms were limited to 10 years if won at a public tender or auction and to one and a half to nine years if no public bidding procedure was followed, thus rendering long-term holding of large leased land banks for future construction virtually impossible. Further, the Land Code outlawed the pre-existing practice of changing category and permitted use of the land (see Section V.i, above) post factum to allow construction on land initially allocated for a different purpose, without paying statutory charges.

In addition, as of 1 June 2015, the Russian Civil Code prohibits assignment of leases won through a public bidding procedure, delegitimising direct transfer of ownership in ongoing construction projects on state and municipal land.

iv Ongoing legislative reform of shared participation in housing construction

A shared participation in housing construction agreement is entered into between a developer wishing to attract external financing for housing construction and a number of private investors (mainly individuals) wishing to buy flats or apartments (mainly for accommodation). Starting from 2004, when legislation on shared participation in housing construction was enacted, the problem of deceived private investors arose because relevant laws had not provided for effective guarantees and collateral in favour of the investors securing developer's obligation to put an apartment building into operation and transfer relevant flats and apartments to the investors. As this is a socially sensitive issue, in 2017 the legislator introduced major amendments to the relevant law that mainly shift risks of developer's insolvency and negligence from private investors to the banks providing financing for development, and a newly created insurance fund that accumulates regular contributions from all accredited developers to cover the mentioned risks.

VIII OUTLOOK AND CONCLUSIONS

More significant changes to the legal framework are forthcoming. Russian civil law is undergoing a major reform, which started in 2012, in relation to changes made to the general provisions of the Civil Code, including changes to, *inter alia*, civil law principles, and the validity of transactions, pledge and objects.

The draft law on amendments to the Civil Code includes a separate section regarding real property, and the current section of the Civil Code in this regard will be completely redrafted. It is expected that the amendments to the real property section of the Civil Code will be adopted in 2018. The most notable changes envisaged by this draft law are the following:

a the introduction of a new concept of 'actual possession' of real property, which generally means that any person that has actual possession over real property may defend such actual possession, even if such possession is unlawful. The procedural rules that must be adhered to while defending actual possession will be simpler and require only proof of actual possession, in comparison with the general procedural rules that require proof of title to real property. This new concept is intended to protect *bona fide* owners of real property;

b new rights *in rem*, including the following:

- building leasehold, which may be provided for at least 50 years but not more than 100 years, and allows a person granted this right to develop a land plot (currently all developments on land plots are carried out under long-term lease agreements, which are considered to be a less secure right to a land plot than a building leasehold);
- emphyteusis or perpetual lease granted for an indefinite term or, if a term is envisaged, such a term may not be less than 50 years, with the purpose to use natural characteristics of the land plot (e.g., for agricultural activity, forestry, fishing);
- independent mortgage, which may be established and become effective even if there is no obligation to secure at the time the mortgage is established (currently, a mortgage becomes effective only once the relevant underlying obligation that is secured by the mortgage is created);
- usufruct or social lease, which may be granted to an individual or non-commercial organisation for the use of real property (land plot, premises, etc.) for a fixed term or for life (in the case of non-commercial organisations, the term must not exceed 20 years);
- right to acquire real property owned by a third party, which is an independent right of a person to purchase relevant real property on agreed terms. The maximum term for such a right is 10 years; and
- right to secure provision of consideration by the owner of real property, which gives an entitled individual the right to receive certain consideration (money, goods, etc.) from an owner of real property and, in the event of the owner's failure to provide such consideration, to levy execution on real property. This right may be provided for life or for a fixed term (but not for more than 100 years).

Most of the above rights *in rem* are expected to replace lease arrangements, which are currently used for the same purposes as those rights *in rem* and to provide more security to the person entitled to such rights.

Chapter 27

SCOTLAND

John Bingham[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

Absolute ownership is the sole method of private ownership of real estate in Scotland. It was not always so. Scottish land law developed along feudal lines with ownership of land split into *dominium utile* held by the vassal, *dominium directum* held by the superior and *dominium eminens* representing the ultimate interest of the Crown. However, the last vestiges of the feudal system were swept away by the Abolition of Feudal Tenure etc. (Scotland) Act 2000, and ownership in land became singular and absolute.

Ownership of real estate carries with it ownership of land, all that is fixed to land (including buildings) and that which lies beneath the surface of the land, including minerals, and all airspace above it. Various elements of this whole can be conveyed and owned separately, for example, ownership of a section of air space, as happens with flatted properties.

Co-ownership of real estate is recognised, and co-owners can divide ownership of the whole into any proportions they chose.

Long leases of real estate are competent within limits. Long leases are not regarded as a form of ownership, as is the case in England, but rather as a burden on ownership. Historically, this distinction was more one of theory than substance. However, substance has been added in recent years via various legislative measures. Initially, these measures related to residential property only,[2] but from 2004 commercial long leases have been restricted to a maximum period of 175 years,[3] and from 2015 all commercial leases with more than 175 years to run have been converted automatically into absolute ownership.[4]

Scotland has no concept of equity and ownership is not split into 'legal' and 'equitable' portions; however, a functionally similar division can be achieved in Scotland via its law on trusts.

ii System of registration

Scotland is home to the oldest national continuous public land register in the world.[5] In 1617, the 'old' General Register of Sasines (GRS) was created as register of deeds.[6] The GRS

1 John Bingham is a director at Bellwether Green.
2 The Land Tenure Reform (Scotland) Act 1974, Section 8 (as amended) prohibits the creation of long leases of dwellinghouses for a period in excess of 20 years.
3 Abolition of Feudal Tenure etc. Act 2000, Section 67.
4 Long Leases (Scotland) Act 2012, Section 4.
5 Registers of Scotland - https://www.ros.gov.uk/services/registration/sasine-register.
6 Registration Act 1617.

operates today but as a repository of titles yet to be transferred onto the Land Register of Scotland (LRS). The LRS is a digital map-based public record of land ownership in Scotland, which replaced the GRS pursuant to the Land Registration (Scotland) Act 1979.[7]

Nowadays, almost all dealings in land are registered in the LRS. This has resulted in a migration of titles from the old system to the new on a transaction-by-transaction basis. However, as of 2014 only about 58 per cent of titles had migrated.[8] Concerns that completion of the LRS might take centuries has provoked legislation to accelerate the process.[9]

The transfer of ownership in land can be achieved only by registration in the LRS and occurs at the point of registration.[10] However, registration does not have this effect if the underlying deed that gives rise to registration is legally invalid. That said, legally invalid titles can be cured by subsequent purchase by a party acting in good faith,[11] or by prescriptive possession for 10 years.[12]

A state-backed guarantee of title exists in Scotland. At the date of registration, the title sheet is warranted to the owner as accurate[13] unless the title sheet includes an express statement to the contrary. If loss occurs because of a breach of warranty, compensation will be payable,[14] subject to certain restrictions.[15]

iii Choice of law

Scottish courts will generally apply the choice of law as made by contracting parties. For example, Rome 1 applies.[16] *Dépeçage* applies, allowing different issues within a contract or transaction pertaining to real estate to be governed by the laws of different states. Absent the parties making a choice of law, *lex rei situae* applies to contractual obligations pertaining to real estate in Scotland.

Scots law applies in relation to the formalities of conveyance of real estate, for example its registration and the transactional taxes arising consequent upon its transfer.[17]

II OVERVIEW OF REAL ESTATE ACTIVITY

The total capital value of commercial real estate in Scotland is circa £50 billion.[18] Transaction values for the decade to 2017 averaged £2.92 billion per annum.[19] Edinburgh and Glasgow

7 Now superseded by Land Registration (Scotland) Act 2012 (LR(S)A 2012).

8 Registers of Scotland 10 Year Property Market Report 2004–2014 page 5, accessible at: https://www.ros.gov.uk/__data/assets/pdf_file/0008/3977/RoS10yearreport2004-2014.pdf.

9 LR(S)A 2012, Section 29.

10 LR(S) A 2012, Section 50(2).

11 LR(S)A, Section 86.

12 Prescription and Limitation (Scotland) Act 1973, Section 1, as amended by LR(S)A 2012 Schedule 5, paragraph 18.

13 LR(S)A 2012, Section 73.

14 LR(S)A 2012, Section 77.

15 LR(S)A 2012, Section 78.

16 Council Regulation (EC) No. 593/2008 on the law applicable to contractual obligations (Rome I) (17 June 2008) (OJ 2008 L177/6), 'a contract shall be governed by the law chosen by the parties.'

17 Specifically, Land Buildings and Transaction Tax (LBTT).

18 Commercial Real Estate and The Scottish Economy, commissioned by the Scottish Property Federation, June 2015, report by Colin Jones and Edward Trevillion, page 1.

19 10 Year Property Market Report, Registers of Scotland, 2007–2017, page 30.

are Scotland's major commercial hubs. Over the past decade these cities shared 43.5 per cent of all transactions, by value.[20] Aberdeen is Scotland's third city, although the fortunes of its property market are intricately linked to the oil industry and specifically to the price of oil.[21]

Scotland's economy, in common with that of the UK, is services-led. Retail property represents the biggest single asset class for investors, comprising 43 per cent of total value and approximately 60 per cent of the Scottish investment market.[22] Most investment-grade retail is in the city centre, with Glasgow leading the way. Early in 2017, yields dipped as low as 4 per cent for prime central Glasgow retail assets.[23]

Offices are another major asset class, representing about 25 per cent of the market by value.[24] Investment grade opportunities tend to be focused on Edinburgh and Glasgow. Edinburgh remains a significant financial centre, although its status suffered somewhat as a result of the financial crisis. Prime yields currently sit between 5.5 per cent and 6.5 per cent.[25]

Scotland's industrial sector has seen something of a resurgence in recent years. As an asset class it represents 22 per cent[26] of commercial real estate by value, with investor interest increasing significantly in recent years as yields on retail and offices have fallen. The central belt is a significant location for investors. The anticipated boom in distribution centres for online retail has yet to meet expectations, although in 2016 Amazon signed up to a 385,000 square feet distribution unit just outside of Bathgate.

The investment market for student accommodation has boomed in recent years, buoyed by the Scottish government offering all EU students university places free of tuition fees. Hotels are also big business, especially in Edinburgh, which ranks second in the UK and fifth in Europe for revenue per available room.

The private rented sector has still to take off in Scotland, although Scotland's largest investment deal in 2017 was the £215 million purchase by Moda and Apache Capital from Grosvenor of a part-built site at Fountainbridge, Edinburgh. This promises the delivery of 525 new homes for rent by 2022.

The prospect of Brexit affects Scotland, and overall investment volumes are down in 2017.[27] Scotland also wrestles with a further constitutional issue in the shape of its relationship with the UK. Scottish secession has rarely been a serious question since the Act of Union of 1707; however, the creation of a separate Scottish Parliament in 1999[28] appears to have given a platform to the nationalist sentiment it was designed to placate.

20 Ibid page 32.

21 Transaction values dropped by 60–70 per cent from Q2 2015 as compared to the preceding two years, consistent with the plunge in crude oil prices commencing Q4 2014.

22 Commercial Real Estate and The Scottish Economy, commissioned by the Scottish Property Federation, June 2015, report by Colin Jones and Edward Trevillion, page 3.

23 Purchase by Tanyari, a Geneva-based investor of 55–59 Buchanan Street, Glasgow. See also purchase of Jenners Department Store, Edinburgh for £53 million and yield of 4.64 per cent.

24 Commercial Real Estate and The Scottish Economy, commissioned by the Scottish Property Federation, June 2015, report by Colin Jones and Edward Trevillion, page 3.

25 Inferred from: 81st Scottish Property Review, Ryden, October 2017, page 15.

26 Commercial Real Estate and The Scottish Economy, commissioned by the Scottish Property Federation, June 2015, report by Colin Jones and Edward Trevillion, page 3.

27 Scottish Property Confederation Commercial Property Market Report Q3 (July-September) 2017.

28 Scotland Act 1998.

III FOREIGN INVESTMENT

Scotland mirrors the UK in being a very open economy. There are no restrictions to owning or transacting with Scottish real estate based on the domicile of the investor. Similarly, there are no currency controls or additional transactional taxes pertaining to a party because it happens to be foreign.

The capacity of a corporate investor to deal with Scottish real estate generally stands to be determined by the jurisdiction where the corporation is formed. An opinion as to that capacity will almost always suffice as evidence of that capacity.

Scotland has a long history of attracting inward investment. In 2017, it was the most attractive part of UK for foreign investment, outside London and the South East. The bulk of this investment is allocated to trading businesses, but this provides additional underpinning to the property investment market.

IV STRUCTURING THE INVESTMENT

Most law as pertains to investment structures (for example, tax law) is made at a UK level. Consequently, the various onshore and offshore real estate investment structures available in England and Wales, are available, almost identically, in Scotland.

Most real estate in Scotland is held by Scottish or UK incorporated companies. These are tried and tested vehicles that allow for whole or fractional ownership and that offer investors the benefit of limited liability to the extent of the capital they input. However, they are rarely an ideal structure for foreign investors as tax applies at UK rates.

Non-UK companies are free to own property without limit, providing they have capacity to do so within their own jurisdiction, being a jurisdiction recognised by UK law. UK taxation applies to rental income from property located within the UK, but there is no UK corporation tax to pay and in most instances capital gains tax does not apply.

Offshore unit trust structures, property authorised investment funds and real estate investment trusts apply to Scottish real estate, with identical tax advantages as elsewhere in the UK.[29] In addition to these structures, Scots law offers a unique variant in the form of the limited partnership, commonly used to structure funds.

The Scottish limited partnership (SLP) is a standard Scottish partnership formed in compliance with the Limited Partnership Act 1907. An SLP is very similar to an English limited partnership in that it is formed of one or more general partners who run the business and carry the risk and one or more limited partners who passively invest in the enterprise, with risk limited to the loss of the capital they have contributed. This makes SLPs a particularly attractive vehicle for multi-party investor structures where management and control of the fund is maintained by, or on behalf of, the general partner or partners.

However, the SLP is crucially different from English limited partnerships in two related aspects:

a it has a separate legal persona distinct from the partners who compose it;[30] and

b it has the capacity to enter into contracts and to hold property directly on its own account.[31]

29 See companion chapter for England and Wales.

30 Abolition of Feudal Tenure, etc. (Scotland) Act 2000, Section 70.

31 Partnership Act 1890, Section 4(2).

This added dimension means the SLP is very useful in fund structures as both carried interest vehicles (representing the fund manager's interest) or feeder vehicles (representing the investors' interest).

Despite having a separate legal persona in the same way as a limited company, SLPs are taxed on a partnership basis, with UK tax authorities looking through the SLP and assessing profits and capital gains in the hands of the individual partners. This is known as 'tax transparency' and makes SLPs a useful tool in the context of tax structuring, enabling a more tax efficient structure to deliver value to the SLP's investors. Where an SLP is not trading within the UK, no UK tax will be payable by partners who are resident outside the UK.

Until recently, SLP's were not obliged to disclose details of beneficial ownership. This increased the risk that they could be subject to abuse by the unscrupulous and indeed there have been high-profile instances of their misuse.[32] In 2017, The Scottish Partnerships (Register of People with Significant Control) Regulations 2017,[33] introduced following a government consultation,[34] sought to tackle this issue making it mandatory to submit to Companies House details of all 'persons with significant control'. The measures were introduced to improve the transparency of SLPs and to meet the UK's obligations under the EU's Fourth Money Laundering Directive.[35]

V REAL ESTATE OWNERSHIP

i Planning

Virtually all development of land and buildings requires planning permission;[36] this includes any 'carrying out of building, engineering, mining or other operations in, on, over or under the land, or the making of any material change in the use of buildings or other land'.[37]

Applications for planning permission are made to the local authority[38] (of which there are 32 in Scotland) responsible for the area within which the property development is to take place. The local authority has wide discretion to accept or reject applications, albeit the decision-making process stands to be informed by the planning legislation[39] and guidance issued by the Scottish government.[40] The local authority is responsible for creating local

32 For example, SLPs were infamously used as part of the Moldovan bank fraud in 2015, which cost Moldova $1 billion (or 12 per cent of their GDP), and more recently in September 2017 where SLPs were used to channel $2.9 billion from Azerbaijan into the UK.

33 SI 2017/694.

34 Consultation by the Department for Business, Energy & Industrial Strategy, 'Review of limited partnership law: call for evidence.'

35 Directive (EU) 2015/849.

36 A limited number of permitted developments do not require permission, see the Town and Country Planning (General Permitted Development) (Scotland) Order 1992 and the Town and Country Planning (General Permitted Development) (Scotland) Amendment Order 2014, as amended.

37 Town and Country Planning (Scotland) Act 1997, Section 26, as amended.

38 And, if applicable, the National Park Authorities.

39 The Town and Country Planning (Scotland) Act 1997, as amended by the Planning, etc. (Scotland) Act 2006, forms the basis of the planning system in Scotland.

40 Guidance in the form of the National Planning Framework, the Scottish Planning Policy, circulars and Planning Advice Notes.

development plans to set out acceptable development and how places within the local area should change in the future. Any development will need to be in conformity with these provisions if planning permission stands to be granted.

Applicants can, under certain circumstances, appeal planning applications that are refused (or granted with unacceptable conditions attached to them) to either a local review body or the Scottish government.

ii Environment

The environmental impact of the use of property is an increasingly prominent concern of the legislature.

Contaminated land[41]

Local authorities are the primary regulator of the contaminated land regime,[42] along with the Scottish Environmental Protection Agency. Local authorities are obliged to inspect land to identify areas of contamination and ensure it is appropriately remediated. Generally, responsibility for remediation rests with the polluter; however, where the polluter cannot be found or identified, responsibility passes to the current owner or occupier of the land.

The question of who should bear the risk of contamination of land is invariably addressed in property contracts. Where the risk is theoretical, parties tend to agree that the buyer takes on that risk. However, where the land is known to be contaminated any adoption of risk by the buyer will involve an adjustment in the price.

Energy performance certificates (EPCs)

The energy efficiency of buildings is another environmental issue of increasing prominence. Sellers and landlords have been required to provide EPCs for their buildings since 2009, and from 2016, sellers and landlords of certain non-domestic properties[43] need to produce an action plan,[44] with the owner having 3.5 years to carry out works identified in the action plan to improve energy efficiency and reduce carbon emissions. Alternatively, the owner can currently defer such works but must report annually on the operational energy ratings of the building and exhibit a display energy certificate. Penalties exist for failure to comply. Responsibility for carrying out works needs to be considered for any sale or new lease.

41 Contaminated land is defined as land that poses significant harm being caused, or a significant possibility of such harm being caused, to health by reason of substances in, on or under the land and includes harm to the water environment – see Section 78A(2) of the Environmental Protection Act 1990, as amended by Section 2 of The Contaminated Land (Scotland) Regulations 2005.

42 Contaminated land regime introduced by Part IIA of the Environmental Protection Act 1990, as amended by the Environment Act 1995 and further established in Scotland by the Contaminated Land (Scotland) Regulations of 2000 and 2005.

43 Properties that have a gross internal area of greater than 1,000 square metres unless they comply with Scottish Building Standards from 2002 or later.

44 The Assessment of Energy Performance of Non-Domestic Buildings (Scotland) Regulations 2016 (SSI 2016/146) to tackle energy efficiency of Scotland's existing commercial buildings came into force on 1 September 2016.

Currently, there is no prohibition against leasing or selling properties with low EPC ratings;[45] however, this is being considered.[46]

iii Tax

VAT

A supply of land will generally be exempt from VAT; however, there are three exceptions where VAT is chargeable at the standard rate:

a the sale of a commercial property that is less than three years old or partially complete;
b certain classes of commercial property including hotel and holiday accommodation; and
c where the owner has exercised its option to tax in respect of its interest in the property.

Land and building transaction tax (LBTT)

LBTT replaced stamp duty land tax (SDLT), with effect from 1 April 2015. LBTT is a tax charged on any relevant land transaction,[47] being the acquisition of a 'chargeable interest'.[48] Chargeable interests include a real right or other interest in or over land in Scotland, or the benefit of an obligation, restriction or condition affecting the value of any such right or interest.[49] Certain interests are exempt from LBTT, such as security interests[50] and licences to occupy land.

As with SDLT, there are several tax reliefs applicable to LBTT including sale and leaseback relief,[51] reconstruction relief,[52] acquisition relief,[53] group relief[54] and charity relief.[55]

Under the LBTT regime, tenants of non-residential leases will be required to review the tax paid every three years to take account of any changes in rental level or variations to the lease. Tenants are required also to make an additional LBTT return when the lease is assigned or terminated.

Rates

Non-domestic rates (NDR) are a tax on the occupation of non-domestic property. The tax is calculated on the rateable value determined for the property. Rateable values are subject to review, presently every five years, with the last review effective from 1 April 2017. There is a right to appeal against the rateable values allocated to properties. Certain reliefs are available

45 Contrast with the position in England and Wales where, from 1 April 2018, private landlords will be prevented from letting either domestic or non-domestic properties with an EPC rating lower than E (unless a specific exemption applies). See The Energy Efficiency (Private Rented Property) (England and Wales) Regulations 2015.
46 Considerations for private rented sector: http://www.gov.scot/Publications/2017/04/2510/4.
47 Land and Buildings Transaction Tax (Scotland) Act 2013 Section 1.
48 Ibid Section 3.
49 Ibid. Section 4.
50 Ibid. Section 5.
51 Ibid. Schedule 3 – only exempts leaseback elements of transaction.
52 Schedule 11 of the Land and Buildings Transaction Tax (Scotland) Act 2013, as amended by Revenue Scotland and Tax Powers Act 2014 Schedule 4, paragraph 3.
53 Ibid.
54 Schedule 10 of the Land and Buildings Transaction Tax (Scotland) Act 2013, as amended by the Revenue Scotland and Tax Powers Act 2014 Schedule 4, paragraph 20.
55 Schedule 13 of the Land and Buildings Transaction Tax (Scotland) Act 2013.

to small businesses, charities, properties located in rural areas and empty properties for up to six months depending on the type of building.[56] Listed buildings and properties with a rateable value under £1,700 do not pay NDR.

iv Finance and security

Lenders looking for security over heritable property require a standard security to be granted in their favour by the owner of the property. The standard security must be registered in the LRS[57] and, if granted by a company, it must also be registered at Companies House within 21 days of its creation.[58]

Standard securities are governed by the Conveyancing and Feudal Reform (Scotland) Act 1970, which imposes various obligations on the owner including the duty to maintain the property and restrictions on lettings and altering the property.[59]

VI LEASES OF BUSINESS PREMISES

i Overview

Almost exclusively, commercial leases are a creature of contract and the common law. There is virtually no statutory regime and as a broad principle the terms of the lease will be enforced as the parties have agreed them.

Certain common law presumptions apply if the lease is silent on a matter. For example, at common law it is the landlord and not the tenant who is responsible for repair.[60] As these common law presumptions tend to favour the tenant, these are to a greater or lesser degree displaced in modern practice, especially in relation to matters relating to repair and insurance.

ii Creation

A lease must include four essential elements: parties, subjects, term and rent.[61] If these essentials are present, there is a lease even if the parties state the lease to be a licence to occupy.[62] If any of the essentials are absent, then there is no lease – although the absence of a stated term is, in some circumstances, cured by the common law imputing a term of a year.[63]

56 All empty properties can get 50 per cent relief from NDRs for the first three months that they are empty. They can then get a 10 per cent discount after that. Empty industrial properties can get full relief from NDRs for the first six months that they are empty. Then they qualify for a 10 per cent discount.

57 Land Register of Scotland.

58 Companies Act 2006 (Amendment of Part 25) Regulations 2013.

59 Standard Conditions are set out in Schedule 3 of the Conveyancing and Feudal Reform (Scotland) Act 1970.

60 *Erskine Principles* (21st ed.), II,17. Note: the position is different for rural subjects, but these are infrequently the object of investment.

61 *Gray v. University of Edinburgh* 1962 SC 157.

62 *UK Advertising Company v. Glasgow Bag Wash Laundry* 1926 SC 303.

63 *Redpath v. White* (1737) Mor 15196.

iii Term

A commercial lease can be granted for any term up to but not beyond 175 years.[64] Historically, leases for terms of much more than 175 years were granted. In 2015, almost all such leases that provided more than 175 years to run were extinguished and the tenant's interest under them automatically converted to ownership.[65]

iv Extension of term by tacit relocation

At common law it is assumed, absent a notice to quit, that the parties intend their lease to continue on the same terms, usually for one year, and thereafter from year to year until a valid notice is served.[66]

A notice to quit is simply a communication by landlord or tenant, sufficiently clear in its terms to displace the assumption that the lease is to continue.[67] There is no prescribed mode or form for the communication, but given the challenges of proving oral communication, writing is almost invariably used. A communication made too close to the end date of the lease is ineffective. In most cases (although not all) the communication must be made not less than 40 days prior to the end date.[68]

v Unilateral rights to extend

Tacit relocation apart, a lease ends when it is stated to end, unless the parties agree otherwise. The Tenancy of Shops (Scotland) Act 1949 serves as an exception to this general rule, allowing the tenant of a shop to apply to the court for an extension of its lease for a year on the same terms, on the basis that termination at the scheduled date would cause excessive economic hardship. The Act has rarely been used, and recent case law suggests the courts will be reluctant to exercise the discretion given to them.[69]

vi Rent

Rent is generally paid monthly or quarterly in advance.[70] If no rent is stated, then the agreement will not be a lease but may be a licence to occupy. Rent reviews tend to be five-yearly to the greater of current rent and open market value. Disputes as to review tend to be conclusively determined by an expert valuer, without recourse to the courts. Indexation is an alternative form of rent review. Parties must be careful to ensure any formula is correctly stated, as the courts will tend to apply the formula expressed, even if this leads to manifestly odd results.[71]

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64 Abolition of Feudal Tenure etc. Act 2000, Section 67.

65 Long Leases (Scotland) Act 2012, Section 4.

66 *Douglas v. Cassilis and Culzean Estates* 1944 SC 355.

67 Paton & Cameron, Law of the Landlord and Tenant in Scotland, 1967 page 226.

68 Stair Institutes II,9,38; The Sherriff Courts (Scotland) Act 1907, Section 38.

69 For example, in *Select Service Partner Limited v. Network Rail Infrastructure Limited* 2015 WL 1786087, the Sherriff rejected an application under the Act by a multiple retailer that losing its lease at Waverly Station, Edinburgh would cause it the sort of oppressive hardship the legislature had in mind when enacting the statute.

70 The Scottish quarter dates are the 28th of February, May, August and November per Term and Quarter Date (Scotland) Act 1990.

71 See *Arnold v. Britton* [2015] UKSC 36, general approach to interpretation approved in recent Scottish decisions e.g., *@Sipp Pension Trustees v. Insight Travel Services Limited* [2015] CSIH 91.

vii Formalities

Leases must be in writing, unless they are for a term of one year or less.[72] Leases of 20 years or more must be registered in the Land Register.[73]

viii Function as investment vehicle

The 'full repairing' lease is the holy grail for institutional investors, where all liability for the property is shifted onto the tenant. However, over the past decade there has been a shift in bargaining power towards tenants with a strong covenant, whose very presence in a building or development can increase the value of the landlord's asset.

In large part, much of this bargaining power has been expressed in negotiations in relation to rent, but tenants have made inroads on other key terms also. For example, it is not uncommon nowadays for a tenant's repairing obligations to be restricted by reference to a schedule of condition or for the tenant's liability for common charges (if applicable) to be capped.

ix Disputes

A lease can be registered in the Books and Council and Session for execution. This is an attractive feature of the Scots' system as a lease so registered proves the debt in relation to rent (and other specified periodic payments under the lease) and allows enforcement action to be taken without the necessity of securing a decree. Disputes as to rent are consequentially relatively rare.

In contrast, disputes in relation to dilapidations are common, and much more so in recent years as landlords have sought to secure substantial divorce payments from exiting tenants. A landlord is much more likely to achieve this goal if the lease innovates on the common law position, for example, by including a liquidate damages provision that entitles the landlord to charge the tenant the estimated cost of carrying out the works, irrespective of whether these represent the landlord's loss.[74] However, if there is no innovation on the common law then the tenant is liable for the landlord's losses as assessed by the court. The measure of the landlord's loss does not depend on a single factor.[75] Therefore, while diminution of value arguments can be led, they will not be conclusive in all cases.

x Forfeiture

Landlords can terminate leases for monetary and non-monetary breaches. There are limited statutory restrictions to this power.[76]

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72 Requirements of Writing (Scotland) Act 1995, Section 1(7).
73 Registration of Leases (Scotland) Act 1857 Section 20B as inserted by Land Registration (Scotland) Act 2012 Section 52.
74 *Trustees of Tonsley 2 Trust v. Scottish Enterprise* [2016] CSOH 138.
75 *Duke of Portland v. Wood's Trustees* 1926 SC 640, Lord President Clyde at 651–652.
76 The Law Reform (Miscellaneous Provisions) (Scotland) Act 1985.

VII DEVELOPMENTS IN PRACTICE

i Dilapidations

Dem-Master Demolition Limited v. Healthcare Environmental Services Limited [2017] CSOH 14

A key component of the full repairing lease is that the tenant is to return the premises at the end of the lease in good and substantial repair. At its fullest, this standard obliges the tenant to make good defects, even if they predate the lease. It is to no avail for the tenant to argue that it should not fix something because it was broken when it received it.

Tenants with bargaining power will seek to dilute this liability, and commonly achieve that by recording the condition of the premises at the start of the lease and providing that the premises will be returned in that condition at the end.

However, what happens when the schedule of condition is referred to but not incorporated into the lease? That was the question in *Dem-Master*, where the parties forgot to prepare a schedule of condition at all. The lease provided for the tenant to return the premises, 'in like condition as is evidenced on the said Photographic Schedule'. The landlord argued that as there was no schedule of condition, the reference to it stood to be ignored (*pro non scripto*), and that what remained of the clause placed the tenant under an unqualified, full repairing obligation.

The court rejected this argument, taking the view that the reference to the schedule of condition anchored the tenant's liability to the condition at the date of entry, and that condition was a matter of proof.[77] The court accepted that this conclusion might have been different had there been a statement in the lease that the tenant accepted the premises as being in good repair at the outset.

ii Service charge

AWG Business Centres Limited v. Regus Caledonia Limited and Cheshire West and Chester Council [2017] CSIH 22

In multi-let premises, landlords tend to operate service charge regimes where the common parts of the development remain the responsibility of the landlord, subject to the landlord's right to recover the costs of upkeep from the various tenants.

This case related to an office block in Aberdeen let to AWG and in turn sublet. Defects arose in the common parts of the building some years after its completion. The landlord sought to recover the cost of remedying these defects from the tenant via the service charge. However, the lease stated that, 'expenditure incurred in respect of or pertaining to the initial construction of the Building' was excluded from service charge. The subtenant argued, not unreasonably, that expenditure in making good defects in the initial construction fell within that exception.

The court, while appearing to accept the exception could be interpreted as suggested by the subtenant, rejected that interpretation as being inconsistent with what the court stated to be the full repairing nature of the lease. The court took the view that the lease was full repairing because latent defects were included within the tenant's repairing covenant.

77 *McCall's Entertainment (Ayr) Limited v. South Ayrshire Council (No.2)* 1988 SLT 1421 followed.

iii Tacit relocation

Brucefield Estate Trustee Company Limited (In Liquidation) v. Computacenter (UK) Limited [2017] SC LIV 28

As set out briefly in Section VI, above, a Scottish commercial lease does not terminate at the stated expiry date unless either the landlord or the tenant serves a notice to quit bringing the lease to an end. Tenants who overlook this rule, as many do, suffer the consequence of having to pay rent for a further year at premises they do not want, the landlord, meanwhile, enjoying a windfall.

Here, Computacenter, who were no longer in occupation of premises at Livingston, overlooked to serve a notice to quit, or to communicate otherwise their intention to terminate the lease. The landlord, who had served no notice to quit of their own, sought to charge the tenant rent beyond the expiry date. The tenant refused to pay, arguing that the actions of the landlord amounted to intimation of its intention to bring the lease to an end.

The court reiterated the rule that a notice to quit does not have to be in writing and may be constituted by the actions of the parties. Also, this common law rule was unaffected by a statement in the lease that notices had to be in writing, as a notice to quit was not a notice under the lease.

Notwithstanding, the court rejected the tenant's argument on grounds that the actions of the landlord, upon which the tenant sought to rely, fell considerably short of a clear, unambiguous communication of intent to bring the lease to an end.

iv Rent review - time of the essence

AWG Group Ltd v. HCP II Properties 101 GP Limited [2017] CSOH 69

It is not unusual for a landlord to fail to activate a rent review until after the review date. At common law, there is no presumption that the rent review process is time critical. However, a landlord can be personally barred from activating a review if it delays for too long, and its actions, thereby, amount to agreement by acquiescence that the rent should remain as it is.

This argument was presented by AWG, where its landlord had failed to activate a review scheduled for February 2014, and then on March 2016 sold the property, having marketed the building based on the passing rent. The new owner sought to activate the review, and the tenant resisted, seeking a declarator that the right to review had been waived by the previous owner, and that the new owner was bound by that waiver.

While accepting that the new owner could be bound by the acquiescence of the previous owner, the court rejected the tenant's position on two grounds. First, the lease contained an express statement that the landlord would not be personally barred from exercising the review, simply because it has continued to accept rent at the rate prior to the review date. Second, for an argument of waiver to succeed, the tenant must show that it has placed reliance on the abandonment of the right it argues for, and the tenant had failed to do that.

v Servitude and presumption of freedom of property

William Paterson Pollock and others v. Drogo Developments Ltd [2017] CSOH 64

Rights of servitudes equate to way leaves in England. They allow, for example, essential services to be routed through the land of another.

The defender in this case, Drogo, was given rights to lay services across the land of the landowner via a specific route. Drogo exceeded the rights granted, and laid services across other areas of the landowner's land. The landowner sought removal of the services or, alternatively, damages. Drogo resisted the claim but was unsuccessful because its actions were not supported by the servitude rights given to it, having also by their actions restricted the freedom of the landowner to use its land as it wished. Further, the landowner had not acquiesced to the route Drogo had elected to use simply because it had delayed for two years raising an action of removal.

vi What constitutes a road

Trustees of the Grant Trust v. City of Edinburgh Council [2017] CSOH 102

In Scotland, local authorities have the power to adopt and maintain roads for public use.[78] The local authority has control over the road,[79] but the landowner retains ownership. A road is defined as 'any way (other than a waterway)...over which there is a public right of passage... and includes the road's verge...'[80]

In 1912 the Trust and the Council, entered into an agreement to allow the Council to widen the existing road over a six-foot strip of land along the frontage of the Trust's property (the Cricket Club). As part of the agreement, the Council were required to build a boundary wall between the Cricket Club and the road. When the Trust sold the Cricket Club it retained ownership of the area where the wall was built owing to the nature of the description of the Cricket Club in the deed of transfer.

A dispute arose between the Trust and the Council upon the removal of the wall by the Council and planning consent being granted for a development over the Cricket Club. The case turned on whether the Trust had appropriate rights to compel the Council to rebuild the wall (it had not), but it also touched on the prospect of the solum (base area) of the wall being a 'ransom strip',[81] and this may be the subject of subsequent litigation.

Whether the solum of the wall is a ransom strip will tend to turn on whether the wall formed part of the road it bounded.

Reaffirming prior case law, the court indicated that boundary walls 'will normally define the limits of the road'[82] as opposed to forming part of it. The extent of adoption is determined in accordance with legislation, not the Council's own record. The court highlighted if there was a dispute between the landowner and the Council, the landowner should have the ability to challenge the extent of adoption allowed by legislation.

vii Land registration reform

The Scottish government has targeted that by 2024 all land in Scotland will be registered in the LRS.[83] As of September 2017, 62 per cent of titles were on the LRS, the remainder being on the old register, the GRS.[84]

The idea behind this somewhat ambitious goal is to increase 'transparency' as to who owns land in Scotland. The goal is to be facilitated by a process known as keeper-induced

78 Roads (Scotland) Act 1984, Section 1.

79 Roads (Scotland) Act 1984, Section 151(1) definition of 'public road'.

80 Roads (Scotland) Act 1984,Section 151(1) definition of 'road'.

81 A ransom strip is a small piece of land that is needed to access a property.

82 *David Runciman & Sons v. Scottish Borders Council* [2003] SLT 1405 followed.

83 Land Register of Scotland. See: https://www.ros.gov.uk/about-us/news/2014/target-set-to-register-all-of-scotlands-land.

84 General Register of Sasines. See: https://insideros.blog/2017/10/30/completing-scotland-land-register-progress-update/.

registration (KIR), introduced by the Land Registration (Scotland) Act.[85] KIR gives to the civil servants at the LRS the power, without consent of the owner, to transfer property from the old system of registration into the LRS.

Whatever else might be said of this, there are legitimate practical concerns that translating deed-based titles onto a plan-based system, at speed, and without input from owners will inevitably lead to errors and omissions, some critical.

Further, there is no mechanism for objecting to KIR and, unless a manifest error is identified and the keeper agrees, the owner will not be able to alter the title given.[86]

For individual owners, the solution to this is to pre-empt the KIR process and apply personally to have their title taken onto the LRS via voluntary registration.[87] This affords the opportunity to control the process, and ensure that the full extent of a party's ownership is duly reflected. A reduced fee incentive scheme is in place until 2019 to encourage voluntary registrations of this sort.

viii Barclay review of non-domestic rates (NDR)

The Barclay Review of NDR was published in August 2017.[88] The review makes various recommendations, some intended to encourage development. The Scottish government is understood to be intent on implementing most of the recommendations made. Key changes for investors include:

a from April 2018, every new build commercial property will not pay NDR until occupied for the first time, after that the property will benefit from a year without NDR;

b a 12-month delay will be introduced before NDR are increased when an existing property is expanded or improved;

c children's nurseries will be fully exempt from NDR from April 2018; and

d there will be a three-year revaluation cycle instead of five from 2022, with valuations based on market conditions one year prior to the review date rather than the current two-year system.

VIII OUTLOOK AND CONCLUSIONS

A striking feature of the Scottish government's legislative programme of recent years has been its tendency to restrict, in a variety of ways, the rights enjoyed by the owners of private real estate. Most of these interventions have been justified as being in the interests of the public, and none, at this point, take Scotland beyond the norms of other European states. However, these are a striking departure from the *laissez faire* approach to landownership that has held sway in recent decades, an approach that some would argue has made Scotland (and the UK as a whole) a desirable place for private investment.

85 LR(S)A 2012, Section 29.

86 LR(S)A 2012, Section 80 provides for rectification of the LRS.

87 LR(S)A 2012, Section 27.

88 www.gov.scot/Publications/2017/08/3435.

At present, most of these interventions are in the form of increased rights of tenants of privately owned residential property[89] and community rights to buy privately owned land and property in limited circumstances.[90] Overall, they do not impact negatively on Scotland as an attractive place for investment.

It is worth noting however, that these interventions come with a vision, it being a feature of the Land Reform (Scotland) Act 2016[91] that the Scottish government of the day should issue and keep under review a 'land rights and responsibilities statement' having regard to various and unfortunately vague criteria.

On 28 September 2017, the first such statement was issued by the Scottish government.[92] There are six key principles, of which five are as follows:

1. *There should be a more diverse pattern of land ownership and tenure, with more opportunities for citizens to own, lease and have access to land.*
2. *More local communities should have the opportunity to own, lease or use buildings and land which can contribute to their community's wellbeing and future development.*
3. *The holders of land rights should exercise these rights in ways that take account of their responsibilities to meet high standards of land ownership, management and use. Acting as the stewards of Scotland's land resource for future generations they contribute to sustainable growth and a modern, successful country.*
4. *There should be improved transparency of information about the ownership, use and management of land, and this should be publicly available, clear and contain relevant detail.*
5. *There should be greater collaboration and community engagement in decisions about land.*

89 Private Housing (Tenancies) (Scotland) Act 2016. A key feature of the Act is to give tenants security of tenure subject to removal if the landlord can establish one of various grounds to the satisfaction of the Housing and Property Chamber of the First-tier Tribunal. Also, controversial is the scope given to the Scottish Ministers to designate 'rent pressure zones' and control rents within these zones.

90 Community Empowerment (Scotland) Act 2015 added a community right to buy abandoned, derelict or detrimental land and Part 5 of the Land Reform (Scotland) Act 2016 adds a community mechanism to compel the purchase of private land to further sustainable development.

91 Part 1, Section 1.

92 Scottish Land Rights and Responsibilities Statement, The Scottish Government 2017.

Chapter 28

SERBIA

Marija Marošan and Đorđe Popović[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

In Serbia, any local physical or legal person may acquire ownership right over real estate such as residential and business buildings, apartments, business premises, garages, parking places (within the building), land plots and other real estate except for natural resources that are in state ownership. In addition, the law prescribes that some resources in general use, such as state-owned construction land, forests and forest land, may be subject to limited ownership rights defined by law. Finally, as presented below, agricultural land is also subject to limited ownership rights defined by law.

Ownership is the highest title a person or a legal entity can hold over real estate under Serbian law. The types of ownership are as follows:

a exclusive ownership – the highest level of ownership as this type of ownership is only limited by the statutory limitations (i.e., by-laws);

b co-ownership over real estate – ownership by two or more persons over undivided real estate where each owner's share is determined or a fixed proportion (the owners may have the right to jointly manage the use of the property). Each of the co-owners is entitled to freely dispose of its share; however, other co-owners have a statutory pre-emption right;

c joint ownership – ownership over undivided real estate where the shares of joint owners could be but are not determined or fixed; and

d condominium ownership (ownership over a single real estate unit) – according to Serbian law a single apartment, office, garage or parking space may be the subject of an exclusive ownership right and, therefore, each such single real estate unit is registered in the land registry separately. In contrast to that, each owner of a single real estate unit is at the same time a joint owner of the common parts and areas. The owners may freely dispose of their ownership over single units together with their corresponding shares of the common parts and areas.

ii System of registration

All real properties in Serbia and property rights over them are required to be registered in the land registry. However, in practice, certain portions of real estate are not registered, as some entries in the land registry are outdated for historical reasons and because of the inefficiency

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of the public administration. The land registry operating in Serbia is called the real estate cadastre. The real estate cadastre has been developed in Serbia over the past 20 years. Prior to that, 'technical' data on real estate were registered in the land cadastre, while 'legal' data were registered in land books. The real estate cadastre is a unified registry that contains both technical data (from the land cadastre) and legal data (from the previous land registry). The real estate cadastre has now been established in the majority of cadastral municipalities in Serbia.

Pursuant to the relevant law, all rights over real estate or changes in rights over real estate have to be registered in the land registry within 30 days from the date they occurred. If the said statutory deadline is not complied with, the owner of the relevant real estate can be fined. However, non-compliance with this obligation is rarely (if ever) penalised in practice.

As for the acquiring of title, title over real estate is acquired through its registration in the land registry (i.e., the registration has a constitutive effect). For the new owner to be able to register the land in the land registry, the seller has to provide the purchaser with the *clausula intabulandi* – a provision authorising registration of the new owner in the land registry. This provision may be either included in the contract or attached to it as a separate statement. The state guarantees title by providing compensation for loss that occurs through non-authentic registration or by errors in the operation of the registration system.

iii Choice of law

Under Serbian law, all transactions or agreements related to real property located in Serbia have to be governed by Serbian law, and parties to the contract are not allowed to agree otherwise. For the purpose of clarification, this rule applies to sale and purchase agreements, lease agreements, and other similar agreements, but not to construction agreements. Namely, construction agreements can be governed by foreign law on the general condition that the relevant legal relationship contains a foreign element (e.g., one of the parties is a foreign entity or a Serbian branch of a foreign entity).

II OVERVIEW OF REAL ESTATE ACTIVITY

In general, over the past couple of years there has been no significant increase in the availability of capital to finance real estate transactions in Serbia.

Still, there are a couple of notable movements on the market that may result in such increases in the forthcoming period, including the following:

a as a result of the increasing number of restructuring processes in the financial sector (involving mostly banks, leasing companies and some other financing institutions), there is an ongoing increase in sales of non-performing loans and related portfolios, which often results in the sale of underlying collateral, including valuable real estate assets;

b there is a new trend in the market of implementing public-private partnerships and concessions, all of which involve heavy development of the different real properties. The most outstanding such project, that is currently ongoing, is the concession of the Nikola Tesla Airport;

c there is an increasing trend of Middle East-based capital entering the Serbian real estate market, the Belgrade Waterfront project being the most prominent example. This project, which Serbian officials have publicly stated will eventually be worth more than €3 billion, involves a partnership between Serbian and UAE companies in the construction and subsequent sale of a major commercial and housing real estate complex at a prime location in Belgrade. However, it generates continuous public debate about its overall transparency and feasibility;

d there also appears to be a notable increase in both equity and debt-based financing of projects in specific industries; for example, the renewable energy business (most prominently the development of large-scale wind farms); and

e the retail market, a traditionally underdeveloped segment, has experienced improvements with several finalised projects and a couple in the finalisation phase in Belgrade. The retail market is also steadily developing in cities in Serbia other than Belgrade.

III FOREIGN INVESTMENT

Foreign natural persons and legal entities are allowed to acquire title over real estate, but subject to additional requirements: foreign natural persons and legal entities that perform business activities in the territory of the Republic of Serbia may, on condition of reciprocity, acquire real estate necessary for the performance of their business activities. The existence of reciprocity between the Republic of Serbia and country of origin of the foreign natural person or legal entity has to be confirmed by the Ministry of Justice.

However, even if the above-mentioned conditions are met the state may still forbid the acquisition of real estate in certain areas (e.g., because of the vicinity of military facilities, or vicinity to the state border). Traditionally, agricultural land could not have been owned by foreign physical or legal persons. However, as of September 2017, the Law on Agriculture, under rather strict conditions, allows EU citizens to acquire ownership of up to 2 hectares of agricultural land. In practice, this means that foreign entrepreneurs and foreign legal persons must still either establish or acquire a Serbian legal entity in order to be able to invest in agricultural land.

Also, in practice, foreign entities are rarely registered as owners of real properties. Most commonly, a subsidiary of a foreign entity is established in Serbia for the purpose of acquiring title over real property.

IV STRUCTURING THE INVESTMENT

Typical investment structures on the Serbian real estate market (most commonly in the construction business) are those involving the creation of a 'special purpose vehicle' project company to be considered formally as an investor in the property and thus having title thereto. This structure allows the financiers to have full control over bank accounts and priority of collateral (typically a first rank mortgage), and to inspect business operations more easily. This structure also facilitates the sponsors' equity coming in more transparently and with fewer transaction costs (note also that share capital increase may be preferential tax-wise, as it is principally tax neutral).

Other structures pertain to business conducted through 'classical' transactions, where an existing company purchases the property or the company owning the property. Financing may be diverse, and ranges from intercompany, external, or syndicated loans and equity contributions to mechanisms that are more complex, such as forward purchase and escrow agreements. Collateral includes mortgages, different kinds of pledges, bank guarantees and promissory notes.

In some regulated industry sectors, such as energy or telecommunications, the transaction requires due care being specifically given to permitting and licensing aspects of the target business or property. Because of the frequent changes to regulations and the general ineffectiveness of the public administration, it may be somewhat burdensome for lenders to obtain enforceable step-in rights and otherwise to be in a firm position as regards acquisition of a business as a going concern. As a result, a mixture of debt and equity is often sought to bridge the gaps and secure financing.

V REAL ESTATE OWNERSHIP

i Planning

A facility can be constructed on certain land (i.e., within a certain area) if such a type of construction or facility is allowed by relevant planning documents (spatial and zoning documents) for that specific area. Investors can get information with respect to the development possibilities and limitations of a specific land plot by obtaining information on location. Information on location takes the form of a document issued by the relevant public authority (depending on the type of contemplated construction it can be either Ministry of Urban Planning and Construction, Secretariat for Urban Planning, Construction and Environmental Protection of the Autonomous Province of Vojvodina or a competent municipal or city body) that contains general zoning parameters for development on the basis of applicable zoning ordinances.

ii Environment

Generally, the area of environmental protection is still under-regulated in Serbia. However, owners or users of real estate are generally obliged to use real estate in compliance with all applicable environmental regulations. This applies equally to waste management, prevention of air, land and water pollution, compliance with noise-level requirements and performance of any works pursuant to environmental requirements.

Consequently, an environmental clean-up (including, without limitation, implementation of environmental facilities and measures) will principally be mandatory for any user of real estate if the relevant real estate is polluted, contaminated or otherwise in breach of environmental requirements.

In addition, certain sector-specific requirements may also apply to specific real estate; for example, the obligation to recultivate land used for mining operations after expiry of the allowed period of exploitation.

iii Tax

The transfer of real estate is, as a rule, subject to RETT at a 2.5 per cent rate. This tax is payable by the seller of the property, as the taxpayer. The tax base is the sale price of the property, but the tax authority may adjust the tax base if the sale price is below the estimated market value.

The tax liability is triggered by entry into a real estate transfer agreement (e.g., sale or purchase agreement) or by the buyer starting to use the property. The taxpayer must file a tax return within 30 days from such a taxable moment.

Transfer of real estate is subject to VAT in two cases: (1) on first transfer of newly built property (property built after 1 January 2005); and (2) if the parties contractually agree to apply VAT, provided that the parties are taxable persons registered for VAT and the buyer can deduct input VAT. Such transfers are taxed at a 20 per cent rate, except for residential properties, which are taxed at a reduced 10 per cent rate.

Transfer of business as a going concern is out of the scope of the VAT under conditions prescribed for in the VAT Act. Still, if the transferee ceases to fulfil these conditions in the following three-year period, it is required to calculate and pay VAT on such a transfer. Transfers subject to VAT are exempt from RETT and vice versa.

Transfer of real estate may be subject to inheritance tax and gift tax. Both are payable by the recipient of the real estate. The tax rate for inheritance tax and gift tax depends on whether the recipient is considered to be in the second hereditary order (1.5 per cent) or further hereditary orders (2.5 per cent) in relation to the donor or deceased.

iv Finance and security

The most common form of security granted over real estate in Serbia is a mortgage, which may principally be established both over existing real estate and over real estate in construction. Mortgages may, under Serbian law, principally be established either as court mortgages (i.e., judicial mortgages) or out-of-court mortgages. Consequently, mortgages may be enforced in two different ways: by way of the courts (i.e., judicial enforcement) or out-of-court enforcement. As a matter of principle, please note that the creditor may enforce claims out of court only if such means are envisaged in the relevant security documents, while the court enforcement is generally an option that is available to the creditor in either case (i.e., be it specifically envisaged in the documents or not).

In addition, share pledges and bank guarantees are commonly used to secure real estate financing, even if only indirectly relating to the actual property.

VI LEASES OF BUSINESS PREMISES

Serbian legislation does not differentiate between different types of leases (e.g., commercial, retail, residential), meaning that all those types of leases are regulated by the same law – the Law on Contracts and Torts.

However, lease agreements where the landlord is a public authority (e.g., state, autonomous province, municipality or public entity) may be subject to additional requirements when it comes to their execution, because these cases are further regulated by the Law on Public Assets. Yet, even in such cases, the rights and obligations of the parties are governed by the Law on Contracts and Torts.

The main characteristics of a typical lease are presented below.

i Length of term

The Law on Contracts and Torts provides that a lease agreement may be concluded for either a fixed or an indefinite term, but it does not prescribe the minimum or maximum duration of agreements concluded for a fixed term. The common practice is that retail and office leases are concluded for an initial term of five years.

Lease agreements concluded for a fixed term are considered to be converted into a lease for an indefinite term if the tenant continues to use the leased premises after the expiry of the initially agreed fixed term.

ii Rent increases

Lease agreements commonly provide for indexation of the rent. In addition, a rent can be revised based on a general provision of the Law on Contracts and Torts regulating termination or amendment of an agreement because of hardship. Based on this provision, if events have rendered performance by one party more onerous after conclusion of the agreement than would reasonably have been anticipated when the agreement was concluded (i.e., if its performance has become excessively burdensome because of an event beyond the party's reasonable control, which it could not reasonably have been expected to have taken into account), the relevant party may ask the courts to grant termination or renegotiation of the agreement.

iii Tenant's right to sell or sublease

Under the Law on Contracts and Torts, subleasing does not require the landlord's consent, unless the lease agreement in question specifically prohibits subleasing.

The Law on Contracts and Torts does not specifically regulate the issue of sale of lease by the tenant. Generally, assignment of an agreement is allowed under the condition that the other party agreed to it. However, in practice, landlords prohibit such transfers.

iv Insurance

The Law on Contracts and Torts does not regulate this issue. However, in practice, the cost of property insurance for the building is included in the service charge and thus reimbursed to the landlord by the tenant. Also, the tenant is usually required, on its own account and in its own name, to take out, for example, insurance covering contents and liabilities, including the furniture and goods located inside the leased area, employers' liability insurance, civil and third-party liability insurance.

v Change of control of the tenant

This issue is not regulated by the Law on Contracts and Tort. In general, lease agreements envisage that the tenant is prohibited from exercising change of control (except within the group) without the consent of the landlord. On the other hand, lease agreements also envisage change of control rights for the landlord, usually connected to the possibility of the sale of the property or to the security rights of the financing institutions.

vi Transfer of lease as a result of a corporate restructuring

Lease agreements usually envisage that the rights and obligations of the landlord under the lease agreement can be assumed by its legal successors or assignees, as notified to the tenant, and the tenant undertakes, upon request of the landlord, to sign the assignment and assumption agreement. Also, it is usual that the tenant waives its right to terminate the lease agreement because of transfer of the title over the leased premises.

vii Repair

The landlord is obliged to maintain the premises in proper condition and to perform any necessary repairs. The landlord is also obliged to compensate the tenant for costs incurred for repairs that fall under the scope of the landlord's duty.

However, the costs of smaller repairs caused by regular use of the premises, and the costs of the use itself, are borne by the tenant.

VII DEVELOPMENTS IN PRACTICE

i Simplified permitting procedure and increase in the number of issued building permits

An integrated permitting procedure – a type of one-stop shop procedure introduced in December 2016 in which investors are no longer required to collect documentation from public authorities and public utilities providers, but instead this is done by newly established departments that deal with each step in the permitting procedure – has shown positive effects. The number of issued building permits has increased. This increase was additionally stimulated by new electronic system for issuance of construction-related permits that became functional as of January 2016. This led to improvement of Serbia's position in the World Bank's Doing Business 2016 ranking, and even more notable improvement in 2017 (Serbia rose to 36th place).

ii Transferability of location conditions

Location conditions are similar to the 'zoning permit' issued in other jurisdictions, and they contain specific development parameters for a particular facility (i.e., a construction project). They represent a zoning clearance for the project. An important change introduced by the 2015 amendments to the Law on Planning and Construction is that an investor applying for location conditions no longer has to provide evidence of title over the construction land on which the relevant facility will be constructed. Thus, location conditions are no longer linked to title over land, which allows transferability of real estate projects from one investor to another.

iii Introduction of the concept of a 'financier' in construction projects

The latest amendments to the Law on Planning and Construction have introduced a useful concept of a 'financier'. Under the Law, a construction permit can be issued in favour of both investor and financier provided that they have entered into an agreement regulating their mutual rights and obligations. A financier has all the rights and obligations of an investor, except the right to acquire the ownership right over the constructed facility. Since its introduction, the concept has been widely used in practice, especially in energy projects.

iv Providing information regarding provisions of the Law on Planning and Construction

The Ministry of Construction, Transportation and Infrastructure launched a call centre and internet site that should provide interested parties with relevant information with regards to the proper interpretation and application of the Law on Planning and Construction.[2]

v New law regulating conversion of right of use over construction land into ownership right

Prior to 2009, it was not possible to obtain an ownership right over city construction land, but only right of use. Buildings erected on state-owned land could be privately owned, and the private owners of the buildings enjoyed perpetual right of use to the state-owned land underlying the building to the extent necessary for use of the building. During the

2 Call centre: +381 11 40-43-190; internet site: www.gradjevinskedozvole.rs.

conveyancing process relating to a building constructed on state-owned city construction land, the land under the building and the land necessary for the use of the building were automatically included in the transaction.

In 2009, a new Law on Planning and Construction entered into force. Under this law, pre-existing rights to use city construction land were converted into rights of ownership, provided that the titleholder was properly registered in the land registry and no conversion surcharge was payable. Generally, a conversion surcharge was payable if the right to use belonged to an entity undergoing either privatisation, bankruptcy or enforcement proceedings or if undeveloped city construction land was acquired or awarded for the purpose of development prior to 13 May 2003.

In October 2013, the Serbian Constitutional Court repealed the above-mentioned law with respect to entities undergoing privatisation, bankruptcy or enforcement proceedings. Since then, the conditions for conversion of right of use into an ownership right have been prescribed by the amendments to the Law on Planning and Construction that came into force in December 2014. More or less the same rules apply to the conversion under the current legislation as applied in 2009 (with respect to holders of right of use), only the method for determining the conversion surcharge and the conversion procedure have changed.

The procedure for conversion without surcharge is now regulated by the Law on Planning and Construction, while the conversion with surcharge is regulated by the Law on Conversion of Right of Use into Ownership Right over Construction Land with Surcharge adopted in 2015. This brought the two-year period of uncertainty with respect to the issue of conversion to an end.

Considering that as of 28 July 2016 it is no longer possible to obtain construction permit based on right of use as legal title over the relevant land (principally, only ownership right and right of use over publicly owned land are now considered as sufficient title for issuance of construction permit), the number of initiated conversion procedures has increased. Admittedly, the procedure envisaged by the Law is more efficient than it used to be; however, inconsistent application of the relevant provisions (such as those regulating fee calculation and suspension of procedure in case of restitution claims) by competent authorities affects overall efficiency of the conversion procedure. Without conversion, the only option for investors is to, based on the Law on Conversion of Right of Use into Ownership Right over Construction Land with Surcharge, convert its right of use into a long-term (i.e., 99-year) lease by entering into a lease agreement with the owner of the land. Unlike right of use, long-term lease over publicly owned land is considered as sufficient title for issuance of construction permit.

vi Amendments to the Law on Agricultural Land

The amendments to the Law on Agricultural Land adopted in December 2015 introduced new rules with respect to the lease of state-owned agricultural land. Namely, these provided the possibility of a priority procedure for domestic investors (including, of course, subsidiaries of foreign entities) whose projects have been approved by the committee established by the Minister of Agriculture. The ban with respect to the acquisition of agricultural land by foreign natural and legal persons was somewhat lifted in September 2017 – the latest amendments to the Law allowed EU citizens to, under rather strict conditions, acquire up to 2 hectares of agricultural land.

vii Introduction of the concept of a 'security agent'

The 2015 amendments to the Mortgage Law introduced the concept of a 'security agent'. Under the Law, a security agent can be authorised by mortgagees to take legal action with respect to the protection and enforcement of a secured claim. However, the practice has shown that the relevant provisions have not been specific enough so as to avoid certain confusions when acting before state authorities, primarily cadastre offices. Further on, a problematic provision of the old Mortgage Law, which envisaged that the lower ranking mortgages remain in force in case of out-of-court settlement, has been replaced with provision that prescribes that the lower ranking mortgages cease to exist once the mortgage real property is sold in an out-of-court settlement.

viii Amendments to Law on State Survey and Cadastre

In December 2015, amendments to the Law on State Survey and Cadastre came into force. These amendments facilitated and accelerated procedures before the land registry authorities by, for example, allowing online submission of request for registration. Another important novelty is that the amendments allowed for registration of certain contractual rights with respect to real estate such as short-term lease right and contractual pre-emptive right. Looking back, it can be said that the amendments have brought certain amount of efficiency, but further improvements are needed in order to improve the functioning of the land registry to a satisfactory level.

VIII OUTLOOK AND CONCLUSIONS

The Serbian government has already made notable efforts to simplify procedures and allow projects to be developed more quickly by initiating changes to both primary and secondary real estate legislation. As a result, the statutory deadlines for obtaining permits and necessary registrations have been shortened, procedures have been simplified and greater power has been given to investors to protect their rights effectively. The number of issued building permits has increased. This increase was additionally stimulated by new electronic system for issuance of construction related permits that became functional as of January 2016. Since then, the number of issued construction permits has continued to increase. The improvement was recognised by the World Bank – Serbia holds 36th place on the 2017 Doing Business List.

Yet, in practical terms, further flexibility and efficiency in real estate development is still needed, with the highest-level officials pledging publicly to bring about further changes to both legislation and practices in the shortest possible time. This has to be accompanied with transparency and consistent application of the legislation by all relevant authorities and institutions.

Another notable issue remains to be the unfinished process of 'legalisation' (i.e., subsequent obtainment of missing permits for already constructed properties). Bearing in mind the number of properties so constructed in Serbia, the final resolution of this matter would be a significant achievement for both society and the authorities. Steps have been taken to finally resolve this, with policies and regulations now in place to allow for a procedure that is less complex and cheaper.

Finally, a decade-long issue of restitution of unjustly expropriated (i.e., nationalised) properties ought to be finally resolved, while the competent authority should ensure equal protection of all interested parties.

In terms of market trends, while typical housing or business properties are experiencing certain improvements, certain specific industry sectors have seen substantial growth, with the most prominent examples being hotels and leisure facilities, retail and renewable energy facilities. These projects have attracted considerable lending and equity capital over the past couple of years, coming mostly from the United States, South Africa, Western Europe and the Middle East.

Chapter 29

SINGAPORE

Jennifer Chia and Yvonne Lian[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

In Singapore, all land is held by the state;[2] as such, land is not the subject of absolute ownership but of tenure. The state in turn issues various grants or leases of the land. These grants and leases are more commonly known as estates and typically comprise freehold estates, leasehold estates and estates in perpetuity.[3] Each estate is reflective of the duration of the owner's interest in the land.

Freehold estates

There are two main types of freehold estates: fee simple, where a person owns the land indefinitely, without conditions, and upon his or her death, the land passes onto his or her successors (i.e., the closest to absolute ownership); and life estate, where a person owns the land for the duration of his or her lifetime.[4]

Leasehold estates

A leasehold estate lease has a definite duration, typically of 99 or 999 years. However, leases granted by government landlords, the JTC Corporation (JTC) (the industrial landlord) and the Housing and Development Board (HDB) tend to be shorter and typically last for 30 or 60 years. At the end of the lease period, the land will revert to these government landlords, who themselves own the land under the head lease from the state.

Irrespective of the type of estate, all land may be acquired by the state under the Land Acquisition Act of Singapore,[5] and any development of land is subject to planning controls under the Planning Act of Singapore.[6]

Estates in perpetuity

An estate in perpetuity (or a statutory land grant) is an interest in land under which a person owns the land indefinitely, subject to certain conditions such as those set out in the State

1 Jennifer Chia is partner and Yvonne Lian is an associate at TSMP Law Corporation.
2 Tan Sook Yee, Tang Hang Wu and Kelvin FK Low, *Tan Sook Yee's Principles of Singapore Land Law*, 3rd Edition (Singapore, LexisNexis) at 12.
3 *Halsbury's Laws of Singapore Volume 14 (Land)*, 2005 reissue.
4 Such estates are rare in Singapore.
5 Cap 152, 1985 Rev Ed Sing.
6 Cap 232, 1998 Rev Ed Sing.

Lands Act of Singapore (SLA)[7] (e.g., the right of the state to have free access to the land). Pursuant to the SLA, every grant of land granted before 1 March 1961 shall be deemed to confer an estate in perpetuity on the grantee.[8]

ii System of registration

Since the 1960s, two systems of land registration have operated in parallel in Singapore: registration under the Registration of Deeds Act of Singapore (RODA)[9] and registration under the Land Titles Act of Singapore (LTA).[10] However, with the enactment of the Land Titles (Amendment) Act 2001 of Singapore, virtually all land in Singapore has been converted and brought under the latter regime.

Land registered under the RODA

Such land is known as 'unregistered land', and interest in the land is achieved by way of the signing, sealing and delivery of a deed. Registration of the deed with the Registry of Deeds secures priority (which is based on the date of registration) and ensures admissibility as evidence of title to the land in court. One of the key problems with this regime is the tedious process of the checking of title, which typically requires tracing back to at least 15 years prior to a deed registration to ensure a good root of title.

Land registered under the LTA

Such land is known as 'registered land', and the advantage of this system over the unregistered land regime lies in the fact that only one document of title, upon which is endorsed every transaction affecting the particular property, has to be examined. However, registration is mandatory to effect the transfer of an interest in the land and, upon registration, the title is regarded as practically indefeasible. Upon registration, the Singapore Land Registry will issue a certificate of title containing the registration particulars of the title and a legal description of the property; a duplicate certificate of title is to be held by the current registered proprietor as proof of his or her title.

iii Choice of law

Transactions involving real estate in Singapore are typically governed by Singapore law, on the basis of the *lex rei sitae* rule.

Where the proceedings are principally concerned with a question of title to, or right of possession of, foreign immovable property, the Singapore court has no jurisdiction to entertain such proceedings unless the question is based on a contract of personal equity between the parties, or if the question arises in the administration of a trust or the estate of a deceased person that is within the court's jurisdiction.[11]

7 Cap 314, 1996 Rev Ed Sing.
8 Section 4(5), SLA.
9 Cap 269, 1989 Rev Ed Sing.
10 Cap 157, 2004 Rev Ed Sing.
11 Yeo Tiong Min, 'Ch.06 The Conflict of Laws': www.singaporelaw.sg.

II OVERVIEW OF REAL ESTATE ACTIVITY

Land has always been a much sought-after asset in land-scarce Singapore. Coupled with the government's active efforts to attract foreign investors and the increasing appetite for land among domestic players, it is no surprise that the Singapore real estate investment market has traditionally been a favourite with investors. For investors looking to acquire real estate in Singapore, financing can be obtained from banks and finance companies.

In recent years, however, the property market has been sluggish, owing to the successful property cooling measures to curb home prices[12] and an oversupply that has continued to unravel.[13] Nonetheless, recent reports have shown that analysts are confident that Singapore's property market is set to improve.[14] For one, foreign investments in the Singapore property market spiked by 441 per cent year on year in 2016 to US$4.1 billion,[15] signalling an optimistic outlook on the future of the property market in Singapore.

III FOREIGN INVESTMENT

i Acquisition of property

Land in Singapore may be zoned for residential, commercial or industrial purposes. In general, there is no restriction on foreign ownership of commercial or industrial property. However, when a foreign person[16] seeks to transfer, purchase or acquire restricted residential property,[17] the Residential Property Act of Singapore (RPA)[18] provides that approval by the Minister for Law must first be obtained.[19] For the purposes of the RPA, a foreign person includes a company incorporated in Singapore if the company has directors or members who are not Singapore citizens.[20]

Even if approval from the Minister for Law is granted, foreign persons may be required to use the residential property only for their (and their families') occupation, or for their

12 Specifically, the imposition of stamp duty on sale and purchase of immoveable property in Singapore as well as the tightening of property loan rules.

13 Urban Redevelopment Authority, 'Release of 3rd Quarter 2016 real estate statistics' (28 October 2016): www.ura.gov.sg/uol/media-room/news/2016/oct/pr16-66.

14 *The Straits Times*, 'Singapore property analysts turn bullish, predict 5-10% price gain by end-2018' (18 September 2017): http://www.straitstimes.com/business/property/singapore-property-analysts-turn-bullish-predict-5-10-price-gain-by-end-2018.

15 *The Business Times*, 'Surge in foreign buying in Singapore assets: JLL' (28 March 2017): www.businesstimes.com.sg/real-estate/surge-in-foreign-buying-in-singapore-assets-jll.

16 Under Section 2(1), RPA, a foreign person means any person who is not a citizen of Singapore, a Singapore company, a Singapore limited liability partnership or a Singapore society.

17 Under Section 2(1), RPA, restricted residential property includes vacant land, landed housing and land meant for residential purposes, but excludes flats in buildings and units in condominiums as long as they do not comprise all the flats in the building or units in the condominium; and estate or interest in any development for a term not exceeding seven years, inclusive of any further term that may be granted by way of an option for renewal.

18 Cap 274, 2009 Rev Ed Sing.

19 Sections 3 and 25, RPA.

20 Under Section 2(1), RPA, a foreign person includes a person that is not a Singapore company, and a Singapore company is defined as a company that is incorporated in Singapore and whose directors and members are all Singapore citizens.

employees' (and their employees' families') occupation; or ensure that the estate or interest in the residential property is not sold, assigned, transferred or otherwise disposed of within a certain period, among other conditions.[21]

In Singapore, there is a relatively high additional buyer stamp duty of 15 per cent that is levied on foreign purchasers of residential properties.[22] Nonetheless, despite the substantial stamp duty, there remains strong demand for Singapore residential properties from foreign purchasers. This is likely due to the levelling of taxation costs overseas, especially because other popular overseas destinations have also imposed restrictions to curb international demand for property.[23] Singapore's tax rate hence appears lower, and is able to continue to attract foreign investors.

ii Development of property

Foreign persons who wish to purchase residential property[24] for the purpose of constructing flats or dwelling houses[25] for sale must apply to the Controller for Residential Property for approval. Such approval, if granted, may be conditional on: (1) the development being completed within a certain prescribed period; (2) all units in the development not being sold to Singapore citizens or companies within two years from the date a temporary occupation permit is issued under the Building Control Act of Singapore;[26] and (3) where the foreign person is a company, its shares or any interest in such shares shall not be sold, assigned, transferred or otherwise disposed to any other person.[27] Because the failure to complete the development within five years and sell all the units within another two years of obtaining temporary occupation permit for the development could result in foreign developers facing hefty penalties[28] (including the forfeiture of a banker's guarantee equivalent to 10 per cent of the land purchase price), the developers may exert further downward pressure on property prices to avoid such consequences.

Notwithstanding parts (1) and (2) above, foreign persons are allowed to acquire the following without having to comply with the requirements of the RPA: a mortgage, charge or reconveyance of residential property;[29] and residential property by way of tender or otherwise from the Urban Redevelopment Authority of Singapore (URA) or any person or body that is duly appointed as an agent of the government.[30]

21 Section 25(7), RPA.

22 Inland Revenue Authority of Singapore, 'Additional Buyer's Stamp Duty': https://www.iras.gov.sg/irashome/Other-Taxes/Stamp-Duty-for-Property/Working-out-your-Stamp-Duty/Buying-or-Acquiring-Property/What-is-the-Duty-that-I-Need-to-Pay-as-a-Buyer-or-Transferee-of-Residential-Property/Additional-Buyer-s-Stamp-Duty--ABSD-/.

23 *The Straits Times*, 'Singapore property analysts turn bullish, predict 5-10% price gain by end-2018' (18 September 2017): www.straitstimes.com/business/property/singapore-property-analysts-turn-bullish-predict-5-10-price-gain-by-end-2018.

24 The exclusions applicable to restricted residential property do not apply to residential property.

25 Under Section 2(1), RPA, a dwelling house includes a building or tenement for human habitation.

26 Cap 29, 1999 Rev Ed Sing.

27 Section 31(3), RPA.

28 *The Straits Times*, 'Qualifying Certificate scheme: Time for review' (6 March 2015): www.straitstimes.com/opinion/qualifying-certificate-scheme-time-for-review.

29 Section 3(1)(c), RPA.

30 Section 33(e), RPA.

IV STRUCTURING THE INVESTMENT

Real estate investment entities in Singapore commonly take the form of real estate investment trusts (REITs), business trusts, stapled entities or (private) companies.

REITs are the most heavily regulated in terms of business operations; however, at the same time, REITs listed on the Singapore stock exchange (SGX-ST) are accorded the most favourable tax treatment. On the other hand, business trusts and limited liability companies offer unitholders and shareholders respectively the benefit of limited liability.

i Limited liability company

Investment in real estate in Singapore can be done by way of a special purpose vehicle company that holds the title to the real estate. However, the distinction between a Singapore company (as defined in the RPA) and a foreign company is critical. While both types of companies can hold immovable property in Singapore, only a Singapore company may own and hold restricted residential property.

Companies are primarily regulated under the Companies Act of Singapore (CA),[31] and the advantages of relying on a corporate structure to invest in real estate are as follows: it has a separate legal personality such that the company has the capacity to sue and be sued, separate from its shareholders;[32] and it offers limited liability protection for the shareholders (i.e., each shareholder is only liable up to the extent of his or her shareholding).[33]

On the other hand, there are restrictions on the powers of certain companies to hold land. For instance, a company formed for objects not involving the acquisition of gain by itself or by its individual members shall not acquire any land without the approval of the Minister for Finance.[34] In addition, a company generally does not enjoy favourable tax treatment and would be liable for the payment of income tax and goods and services tax (where applicable).

ii REIT

REITs are unit trusts that may be either listed or unlisted and that invest or propose to invest primarily in real estate and real estate-related assets. Essentially, capital is provided by investors in exchange for units in the REIT, and the acquired assets are held by the trustee as a trust property but are managed by a manager.

REITs are regulated by Part XIII of the Securities and Futures Act of Singapore (SFA),[35] the Code of Collective Investment Schemes (CIS Code) published by the Monetary Authority of Singapore (MAS) in 2014 (and last revised by the MAS on 1 January 2016) and the Singapore Code on Takeovers and Mergers of Singapore (Takeover Code) published by the MAS in 2012 (and last revised by the MAS on 25 March 2016). In addition, REITs listed on the SGX-ST are required to comply with the SGX-ST Listing Manual. It should be noted that although listed REITs are structured as trusts, they have their redeemability feature suspended while they are listed: in other words, unitholders of listed trusts can only

31 Cap 50, 2006 Rev Ed Sing.

32 Section 19(5), CA.

33 Ibid.

34 Section 23(2), CA.

35 Cap 289, 2006 Rev Ed Sing.

exit from their investments by selling them on the SGX-ST. As of 30 November 2017, there were 34 listed REITs in Singapore, which span across the industrial, office, hospitality and retail sectors.[36]

Under the CIS Code, real estate investments and activities undertaken by REITs are subject to the following restrictions:

a at least 75 per cent of their deposited property should be invested in income-producing real estate;

b they should not undertake property development activities or invest in unlisted property development companies unless they intend to hold the developed property upon completion;

c they should not invest in vacant land and mortgages; and

d the total contract value of activities and investments undertaken in accordance with (b) should not exceed 10 per cent of their deposited property (with effect from 1 January 2016, such value may exceed 10 per cent of the property fund's deposited property, subject to a maximum of 25 per cent of the property fund's deposited property) provided certain conditions are satisfied.[37, 38]

Although REITs are allowed to borrow for investment purposes and may mortgage their deposited property to secure such borrowings, the CIS Code provides that their total borrowings and deferred payments (collectively, aggregate leverage) should not exceed 45 per cent of their deposited property.[39] Do note that the borrowing limits for REITs with effect from 1 January 2016 have to be seen in light of the amendments to the REITs regulatory regime. Under the Takeover Code, any party intending to acquire 30 per cent or more of the total units of a REIT, or any party holding not less than 30 per cent but not more than 50 per cent of the total units of a REIT, intends to acquire more than 1 per cent of the total units of the REIT in any six-month period, should make a general offer for all units in the REIT.[40]

Listed REITs, unlike other investment entities, are accorded favourable tax treatment in Singapore. First, trustees of listed REITs that distribute at least 90 per cent of their taxable income to unitholders in the same year in which the income is derived and obtain a tax ruling from the Inland Revenue Authority of Singapore (IRAS) are not required to pay income tax on such distributed income.[41] Second, individual unitholders need not pay income tax in respect of distributions from the taxable income of listed REITs, regardless of their nationality or tax

36 Singapore Exchange (30 November 2017): www.sgx.com/wps/portal/sgxweb/home/marketinfo/securities/reits.

37 The conditions to be satisfied are (1) the additional allowance of up to 15 per cent of the property fund's deposited property is utilised solely for the redevelopment of an existing property that has been held by the property fund for at least three years and that the property fund will continue to hold for at least three years after the completion of the redevelopment; and (2) the property fund obtains the specific approval of the participants' at a general meeting on the redevelopment of the property.

38 CIS Code at Appendix 6, paragraph 7.1.

39 CIS Code, at Appendix 6, paragraph 9.2.

40 Securities Industry Council, 'Practice Statement on Real Estate Investment Trusts' (8 June 2007): www.mas.gov.sg; Takeover Code, pages 17 and 73.

41 IRAS, 'IRAS e-Tax Guide – Income Tax Treatment of Real Estate Investment Trusts' (3 November 2015), at paragraph 5.3.

residence status.[42] Third, withholding tax on REIT distributions to foreign non-individual investors would be lowered from 20 to 10 per cent until 31 March 2020.[43] In early 2015, the government decided to extend the tax concessions for REITs, which were scheduled to expire on 31 March 2015, save for the stamp duty concessions, which have since lapsed.[44]

However, the CIS Code does not require the trust deed of REITs to provide that the liability of investors should be limited to their investment in the scheme. Therefore, unlike the beneficiaries of business trusts and shareholders of limited liability companies, unitholders of REITs could conceivably be liable to creditors for the debts of the REIT.[45]

One of the amendments proposed by MAS, which took effect from 1 January 2017, was that REIT managers and individual directors would now be subject to a statutory duty to prioritise the interests of REIT unitholders over those of the REIT manager and the shareholders in the event of a conflict of interest. The imposition of such a statutory duty would be in line with the current obligations on trustee managers under the Business Trust Act of Singapore (BTA).[46]

iii Business trust

Business trusts are business enterprises structured as trusts and are regulated by the BTA.[47] They may be listed on the SGX-ST and, when so listed, will have to comply with the SGX-ST Listing Manual. In addition, the Takeover Code will, unless waived by the Securities Industry Council, apply to listed registered business trusts and unlisted registered business trusts with more than 50 unitholders and net tangible assets of S$5 million or more.[48]

As with REITs, capital in a business trust is contributed by investors in exchange for units in the business trust. However, legal ownership and management of the acquired assets are vested in one single entity: the trustee manager.[49]

The investments, activities and borrowings of business trusts are not subject to any restrictions under the BTA and as such, business trusts, unlike REITs, are free to hold various assets, undertake developments and borrow more than 60 per cent of their deposited property without a credit rating.[50]

In addition, the compulsory squeeze out acquisition of minority unit holdings is also permissible under the BTA.[51] Therefore, an offeror who is making a general offer for units in the business trust will be able to compulsorily acquire the units of the dissenting minority if he or she has obtained acceptances in respect of more than 90 per cent of the units offered.

An advantage of the business trust is that unitholders, like shareholders of limited liability companies, are entitled to limited liability notwithstanding any provision to the contrary in the trust deed of the business trust.[52]

42 Id. at paragraph 8.
43 Id at paragraph 7.1.
44 Stamp Duties (Real Estate Investment Trusts)(Remission) Rules 2010 (S.515/2010 Sing), regulation 3.
45 Lee Suet Fern and Linda Esther Foo, 'Real Estate Investment Trusts in Singapore – Recent Legal and Regulatory Developments and the Case for Corporatisation' (2010) 22 SAcLJ 36 at 62 and 63.
46 Cap 31A, 2005 Rev Ed Sing.
47 Cap 31A, 2005 Rev Ed Sing.
48 Takeover Code at page 3.
49 Section 6, BTA.
50 The Schedule, BTA.
51 Section 40A, BTA.
52 Section 32, BTA.

However, business trusts do not enjoy the same favourable tax treatment offered to REITs. Another disadvantage of the business trust structure is that unitholders may have limited ability to ensure proper corporate governance, as a 75 per cent majority vote of all unitholders is required to remove a trustee manager[53] and, in practice, the sponsor group often retains a significant holding of units sufficient to block any such vote. In contrast, the CIS Code requires the trust deed of REITs to provide that the manager may be removed by way of a resolution passed by a 50 per cent vote of unitholders present and voting at a general meeting.[54]

iv Stapled entity

A REIT may be stapled with a business trust under a stapling deed to form a stapled entity that issues stapled securities. The combined entity will be traded under one trading name, and the two different securities stapled together cannot be traded separately thereafter except in de-stapling events such as termination of the trust.[55]

With effect from 1 January 2016, MAS has imposed a further requirement that the REIT have a sufficient nexus to the non-REIT entity with active operations that it will be stapled to. Such a nexus may be established so long as both are in the same industry or if the entity with active business operations is operating a business or providing a service ancillary to the assets held by the REIT.

Although the stapled structure is recognised by regulators as an allowable listing structure, the underlying securities retain the rights and obligations attached to each of the individual securities. For example, from a tax perspective, the REIT component of the stapled entity will be eligible for REIT-specific tax concessions, while the non-REIT component (i.e., the business trust) will continue to be taxed under normal tax rules.[56]

Stapled entities may appeal to investors who value the business and income diversification benefits brought about by such a combination. To a certain extent, the stapled structure combines the best of both a REIT and a business trust.

V REAL ESTATE OWNERSHIP

i Planning

The Planning Act of Singapore[57] is the primary legislation that provides the legal basis for land use planning and controls in Singapore. Pursuant to the Planning Act of Singapore, no person may develop land outside a conservation area without obtaining planning permission. Likewise, no person can subdivide land without first having obtained subdivision approval pursuant to the Planning Act of Singapore.

The statutory body responsible for carrying out such planning is the URA. The URA publishes a Master Plan every five years, which is a statutory land-use plan that will guide Singapore's development in the medium term (over the following 10 to 15 years). The latest Master Plan is the Master Plan 2014. The Master Plan designates the zoning and permissible

53 Section 20, BTA.

54 CIS Code at appendix 6, paragraph 4.1(a).

55 Singapore Exchange, 'Securities Products, Stapled Securities – Education and Resources': www.sgx.com.

56 Stoscheck, Stefano Simontacchi and Fabrizio Acerbis, *Guide to Global Real Estate Investment Trusts* (The Netherlands: Kluwer Law International, 2011) at 6 (Singapore); see footnote 53.

57 Cap 232, 1998 Rev Ed Sing.

uses of land in Singapore. It is important to check the permissible use of a property prior to its acquisition to ensure that it is in line with the purchaser's intended use. In this regard, purchasers would typically conduct legal requisitions with the planning authority as to the land use zoning of the property.

Where a change of use of a particular premise is desired, an application will have to be made to the URA for permission. If the application is successful, a tax, known as a development charge, will be levied on the applicant if the proposed development project increases the value of the land.

ii Environment

JTC, which leases out most of the industrial land in Singapore, typically imposes environmental clean-up obligations on a lessee whose use of the land is potentially pollutive. If any such lessee wishes to assign its lease to a third party, JTC's consent is usually required. As part of its consent, JTC may require the lessee to conduct an environmental baseline study (to determine the extent of contamination of a particular site) and, if it deems it necessary, require the lessee to carry out an environmental clean-up before assignment of the lease.

Separately, under the Environmental Protection and Management Act of Singapore (EPMA),[58] the occupier of any industrial or trade premises is required to maintain any fuel-burning equipment and any air pollution control equipment installed in or on the premises in an efficient condition, and ensure that such equipment is working in a proper and efficient manner. Failure to abide by these obligations would render the occupier guilty of an offence.[59]

iii Tax

Stamp duty is payable on the acquisition or disposal of immovable property situated in Singapore. The amount of stamp duty payable is computed on the purchase price or market value of the property, whichever is higher, and is payable within 14 days of the date of the instrument effecting the acquisition or disposal of such property (or, where the instrument is executed overseas, within 30 days of receipt of the instrument in Singapore). A penalty of up to four times the amount of unpaid duty can be imposed where there is a failure to pay such duty.

A purchaser is liable to pay buyer's stamp duty (BSD)[60] and, if the property concerned is a residential property, also additional buyer stamp duty (ABSD).[61]

Where the property concerned is a residential property acquired on or after 20 February 2010 and is disposed of within four years of its acquisition, seller's stamp duty (SSD) may be applicable. However, for properties acquired on or after 11 March 2017, SSD is only payable where it is disposed of within three years of its acquisition.[62] The amount of

58 Cap 94A, 2002 Rev Ed Sing.

59 Section 10, EPMA.

60 With effect from 22 February 2014, BSD is calculated as follows: the first S$180,000 – 1 per cent; the next S$180,000 – 2 per cent; and the remainder – 3 per cent.

61 In the case of a purchaser that is a foreign person or non-individual (i.e., a corporate entity), such a purchaser is required to pay ABSD at a rate of 15 per cent on the purchase or acquisition of any residential property.

62 IRAS, 'Seller's Stamp Duty for Residential Property': https://www.iras.gov.sg/irashome/Other-Taxes/Stamp-Duty-for-Property/Working-out-your-Stamp-Duty/Selling-or-Disposing-Property/

SSD payable varies according to the holding period.[63] With effect from 12 January 2013, SSD is also payable on industrial properties acquired on or after that date and sold or disposed of within three years.[64]

iv Finance and security

The most common forms of security over real estate situated in Singapore are the mortgage and the charge.

A mortgage operates by way of an outright conveyance of the borrower's title (as the owner of the property) in the property with a proviso that the lender will reconvey the property when the borrower has performed his or her obligations under the loan. Where separate title for the property has been issued, the mortgage must be registered with the Singapore Land Registry in the approved form. Where separate title for the property has not been issued, an assignment of the rights, title and interest under the relevant contract (for instance, a sale agreement) coupled with a mortgage-in-escrow is effected instead.

A charge creates a security interest in the property, but without an outright conveyance of the property itself. As with a mortgage, the formalities depend on whether the land is registered or unregistered, and whether separate title has been issued.

Other forms of security that are commonly taken over interests emanating from real estate situated in Singapore include an assignment of sale and rental proceeds, an assignment of insurances over property and debenture (fixed and floating charge over a company's assets).

VI LEASES OF BUSINESS PREMISES

In Singapore, the primary statutes governing leases are the Conveyancing and Law of Property Act of Singapore (CLPA)[65] (in particular, Part III on leases), the LTA (in particular, Part IV on leases) and the Civil Law Act of Singapore.[66]

The formalities that apply to leases in Singapore differ depending on whether the leased premises are registered or unregistered. Where registered land is concerned, Section 87 of the LTA provides that leases with a duration of over seven years may be registered with the Land Titles Registry (the Registry). However, in practice, not all leases with a duration of over seven years are registered at the Registry. This is because some landlords are unwilling to grant tenants registrable leasehold interests and, as such, prohibit them from registering their interests at the Registry.[67] Where unregistered land is concerned, Section 53 of the CLPA provides that a lease with a duration of over seven years must be established by deed in the English language.

Seller-s-Stamp-Duty--SSD--for-Residential-Property/.

63 To ensure that the seller has duly paid the SSD, the purchaser may request a copy of the stamp certificate from the seller's lawyer as proof that SSD has been paid. All sellers of residential and industrial properties are also required to complete a seller's stamp duty declaration form when disposing of the property.

64 IRAS, 'Seller's Stamp Duty (SSD) for Industrial Property': https://www.iras.gov.sg/irashome/Other-Taxes/Stamp-Duty-for-Property/Working-out-your-Stamp-Duty/Selling-or-Disposing-Property/Seller-s-Stamp-Duty--SSD--for-Industrial-Property/.

65 Cap 61, 1994 Rev Ed Sing.

66 Cap 43, 1999 Rev Ed Sing.

67 Such prohibitions are typically contractual and provided for in the lease agreement.

It should be noted that in land-scarce Singapore, the provisions of a typical Singapore lease of commercial premises tend to be extremely landlord-friendly, and unless the tenant has strong bargaining powers, it will be difficult to amend the provisions in the tenant's favour. For instance, the landlord usually does not make or give any representations or warranties as regards premises leased on an 'as is where is' basis.

The main characteristics of a typical occupational lease of commercial premises in Singapore are as follows.

i Term

Generally, the term of the lease (or, where there is an option to renew, the aggregate term – e.g., three years plus three years) will not exceed seven years. This is because, under the LTA, the Registrar will not be obliged to register a lease unless it exceeds seven years.[68] There is usually an option to renew for a further term within the lease at a rent rate either pre-agreed upon by both parties or at the prevailing market rent rate at the time of renewal.

ii Rent and rent increases

Since the implementation of the Control of Rent (Abolition) Act 2001 of Singapore, rents have been freely negotiated in Singapore.

Where the term of the lease is relatively short (three years or less), rent is usually fixed throughout the term. However, where the term of the lease is longer, there may be provision for rent revisions, subject to a cap or pegged to the prevailing market rental rate. Notwithstanding the above, a rent revision clause is almost invariably included in leases of commercial premises to ensure that the current market value of the demised premises is reflected. Where the lease is in respect of retail spaces in shopping malls, rent is usually pegged to a percentage of the tenant's monthly revenue.

In addition to the rent, the landlord may require the tenant to pay the service charges (for all outgoing costs and expenses in respect of insurance, lift and air-conditioning services, repair services, etc.).

On a related note, payment of a refundable security deposit (usually equivalent to two or three months' gross rent) is common practice and is payable by the tenant upon its acceptance of the letter of offer. The security deposit will usually be refunded to the tenant without interest after the expiration of the term and the delivery of vacant possession of the demised premises. However, if the tenant commits a breach of any provisions of the lease agreement, the landlord is entitled to apply the security deposit to make good the breach.

Where the tenant intends to carry out renovations or fitting-out works prior to taking possession of the premises, a refundable fitting-out deposit is also payable by the tenant.

iii Tenant liability and obligations

The usual obligations imposed on the tenant are generally to pay rent, to keep the premises in repair (fair wear and tear excepted), to permit the landlord to view the premises, and not to assign, sublet or part with possession of the premises without the consent of the landlord. In addition, the tenant is usually required to take out a public liability insurance policy (in the joint names of the landlord and tenant) with an insurance company approved by the landlord, at the tenant's sole cost and expense.

68 Section 87, LTA.

iv Security of tenure

Previously, security of tenure was available for tenants who satisfied the requirements under the Control of Rent Act of Singapore (CRA).[69] However, the CRA was abolished with effect from 1 April 2001.

v Covenants and conditions; compulsory acquisition

The LTA and CLPA provide for certain implied covenants and conditions in respect of a lease.

Where registered land is concerned, Section 93 of the LTA (implied powers of lessors) provides that the landlord has the power to enter the premises and view the state of repair, and to require the lessee to repair any damage within a reasonable time. However, such statutory powers may be varied or negated by express provision in a particular lease. In addition, where the lease contains a non-assignment covenant (subject to landlord's prior consent), Section 17 of the CLPA provides that such a provision shall be deemed to be subject to a proviso that no fine or sum of money is payable for the landlord's consent, unless the lease contains an express provision to the contrary. Section 18 of the CLPA also qualifies the landlord's right of re-entry and forfeiture for a breach of covenant or condition of the lease in that the lessor is required to first serve on the lessee a notice specifying the breach and requiring the lessee to remedy the breach, if applicable.

The landlord may at any time, without liability to the tenant, terminate the lease where the relevant government authority compulsory acquires the premises pursuant to the Land Acquisition Act of Singapore.[70]

VII DEVELOPMENTS IN PRACTICE

i Introduction of Additional Conveyance Duties (ACD)

On 10 March 2017, the Singapore government announced the introduction of ACD to address the differential treatment in stamp duty between a direct acquisition or disposal of residential properties and an indirect acquisition or disposal of residential properties via a transfer of equity interest in a property holding entity (PHE).[71] Enacted under Section 23 of the Stamp Duties Act,[72] ACD for PHEs acquiring shares applies where the grantee is a significant owner of the entity immediately before the execution of the conveyance or becomes one upon the execution of such conveyance, and the entity is a PHE at the time of the execution.[73] A qualifying disposal occurs when the seller, along with any of its associates, is a significant owner of the residential PHE, and the equity interest of the PHE that was disposed of was acquired on or after 11 March 2017, and is disposed of within three years of acquisition based on a first-in-first-out basis.[74] ACD essentially becomes a *de facto* ABSD on

69 Cap 58, 1985 Rev Ed Sing.

70 Cap 152, 1985 Rev Ed Sing.

71 IRAS, 'IRAS e-Tax Guide Stamp Duty: Additional Conveyance Duties (ACD) on Residential Property-Holding Entities' (10 March 2017) at paragraph 2.1

72 Cap 312, 2006 Rev Ed Sing.

73 Cap 312, 2006 Rev Ed Sing, section 23(2)

74 IRAS, 'Stamp Duty: Additional Conveyance Duties (ACD) On Residential Property-Holding Entities' (10 March 2017) at paragraph 4.1

the purchase of shares in these entities that have property-owning special purposes.[75] Under this provision, a qualifying acquisition or disposal of equity interest in a PHE will therefore be treated as a transfer of interest in the properties, attracting the imposition of ACD in addition to the share transfer duty.

While it might appear that the scope of ACD is wide-ranging, it is restricted purely to entities which own substantial interests in residential properties. As such, if the entity and its associates do not have a significant interest in the residential PHE after the acquisition, ACD will not be applicable. It remains to be seen how the introduction of ACD will further affect the property market, and in particular, residential PHEs.

ii Reduction in SSD rates

In the same sitting, the Singapore government decided to relax the SSD from four years to three years for properties purchased on or after 11 March 2017. It also reduced the SSD rate by four percentage points, with sellers of properties within the first year paying a stamp duty rate of 12 per cent instead of 16 per cent. However, as the Managing Director of the MAS, Ravi Menon, has said, the recent easing of the property cooling measures should not be viewed as a signal that the government would continue to ease these property cooling measures.[76]

iii The URA and land sales in Singapore

The URA, which is Singapore's land use planning and conservation authority, manages the sale of government land in Singapore. For sites on the Reserve List System, applications can be made on the Government Land Sales Programme.[77] A site on the Reserve List System will be put up for sale if a developer's indicated minimum price in his or her application is acceptable to the government. The government will also consider launching a Reserve List site for sale if it has received sufficient market interest for the site.[78]

An application may be made by either an individual or a company (firm). Applicants should submit only one application per site – if more than one application is received from an applicant, only the application with the highest minimum price will be considered. For the minimum bid to be accepted, it must amount to at least 85 per cent of the Chief Valuer's estimated market value for the site. The successful applicant's identity will not be revealed. Upon acceptance of an application, and upon execution of an agreement to submit a tender price not less than the minimum price and the payment of a deposit[79] of 3 per cent of the

75 *The Business Times*, 'Time to rethink investment in residential property' (31 March 2017): http://www.businesstimes.com.sg/hub-projects/property-march-2017/time-to-rethink-investment-in-residential-property.

76 CNBC, 'MAS: Singapore property cooling measures remain necessary' (29 June 2017): https://www.cnbc.com/2017/06/29/mas-singapore-property-cooling-measures-remain-necessary.html.

77 URA, 'Reserve List Procedures': www.ura.gov.sg.

78 This happens when more than one unrelated party has submitted a minimum price that is close to the government's reserve price (which depends on a number of factors, including prevailing market conditions, number of independent bids received for the site and specific circumstances of the site) within a reasonable period (roughly six months).

79 The deposit is refundable provided the bid is in accordance with the agreement, but not to the highest bidder in the tender.

minimum price (capped at S$5 million), the successful trigger of the site will be announced publicly. Tender proceedings typically last for a period of four weeks, with larger and more complicated sites enjoying a longer tender period.

There has been a surge in the number of en-bloc sales in 2017. As of 6 November 2017, the Minister for National Development Lawrence Wong has indicated that a total of about 2,700 private residential units have been sold en-bloc in 2017, up from 600 units in 2016.[80] The pick-up could possibly be due to the stabilisation of private home sales following from the property cooling measures, with new private home sales growing by 7.2 per cent year-on-year, from 7,440 units sold in 2015 to 7,972 units in 2016.[81]

VIII OUTLOOK AND CONCLUSIONS

Studies appear to suggest that diversification remains a central strategy adopted by Singapore property developers in their efforts to cope with the string of cooling measures introduced over the past three years on the purchase of Singapore residential properties.[82] The inclusion of overseas investments into the portfolio might be driven by speculations of high potential relative returns due to the strong exchange rate and low cost of funding.[83] However, a prospective pitfall in the form of currency volatility due to the depreciation of major currencies and normalisation of monetary policies might limit overseas opportunities.[84] Hence, a strategic paradigm shift might be underway as it has been noted that some developers are turning their attention instead to mergers & acquisitions and the en-bloc market, probably due to expected escalating pressures from ABSD.[85] In this regard, there might be a positive correlation between the spike in en-bloc sales and an upward property market. Nonetheless, some have noted that the past three to four years have been relatively quiet on the property front, thereby providing a low basis for comparison.[86] It remains to be seen if the optimism towards the property market will stand.

80 Today, 'Spike in en-bloc sales may not lead to property bubble: Lawrence Wong' (6 November 2017): www.todayonline.com/singapore/sharp-jump-number-homes-sold-en-bloc.

81 Channel News Asia, 'Residential en bloc market poised to pick up: Analysts' (11 April 2017): www.channelnewsasia.com/news/singapore/residential-en-bloc-market-poised-to-pick-up-analysts-8703108.

82 DBS, 'Singapore Developers & Reits' (Singapore Industry Focus, DBS Group Research, Equity, 6 January 2017) p 12.

83 Ibid.

84 Ibid, p 13.

85 Ibid.

86 Today, 'En-bloc market stirs, but frenzy unlikely to ensue' (29 June 2017): www.todayonline.com/business/en-bloc-market-stirs-frenzy-unlikely-ensue.

Chapter 30

SLOVENIA

Dunja Jandl, Ivan Kranjec and Vesna Tišler[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

There are three main general types of title to real estate under the Law of Property Code (SPZ):[2] ownership right, condominium and building right. Ownership right as exclusive ownership encompasses the right of possession, right of use, enjoyment of the right in its widest scope and the disposal of this right. Ownership right is normally not limited by condition or a time limit and can be restricted solely if provided so by law or by will of the owner. Further, the SPZ acknowledges different types of ownership rights: (1) co-ownership – defined as ownership by two or more persons of an undivided object where the share of each owner is determined as part of the entirety of the object; and (2) joint ownership – defined as ownership by two or more persons of an undivided object where the share of each owner is not determined as part of the entirety of the object in advance. Condominium is a type of ownership where each owner of a single real estate unit (e.g., an apartment) is necessarily also a co-owner of the common parts and areas of the building in condominium ownership, and of land surrounding the building necessary for the use of the single real estate unit. The owners may freely dispose of their ownership of single units together with their corresponding shares of the common parts and areas. The co-ownership of common parts and areas and the exclusive ownership right in regard to a single real estate unit cannot be subject to separate transfer.

Pursuant to Slovenian real estate law, the principle of unity of title to land and building (*superficies solo cedit*) applies. Discontinuance of this fundamental principle of real property is the existence of the building right, as well as the aforementioned condominium right. A holder of a building right is an owner of a building but not of the land.

The SPZ provides that acquisition of ownership of real estate is possible either on the basis of a binding agreement, by inheriting, by virtue of law or by virtue of a decision of a competent court.

ii System of registration

The Land Register Act (ZZK-1)[3] provides the general principles with regard to the registration of property rights and the procedural rules for entry of such rights into the Land Register.

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2 Law of Property Code (SPZ) (Official Gazette of Republic of Slovenia, No. 87/02 and 91/13).

3 The Land Register Act (ZZK-1) (Official Gazette of Republic of Slovenia, No. 58/03 with amendments).

In principle, all real estate in Slovenia should be registered in the Land Register. While entry in the Land Register is not obligatory by law, if an individual does not enter his or her right in the Land Register, that individual is solely responsible for the consequences of lack of registration. The ZZK-1 provides the following rights to be entered into the Land Register:

a *in rem*: the ownership right, mortgage, the land charge (no longer possible under the SPZ but still existing in the Land Register), easement, encumbrance, building right and condominium; and

b obligation rights: prohibition of alienation or encumbrance, lease, pre-emptive right, right of repurchase, special right for use for the public good, and other rights if so provided by law.

The ZZK-1 provides for different types of entry in the Land Register: main or secondary entries. Register of right, note and advance notice are main entries, whereas the land registry seal and additional entry are secondary entries. The registration of a right is considered as the most important entry, being either constitutive or declaratory in nature. An entry is constitutive in nature when acquisition of the right or its termination is effective from the moment of its entry in the Land Register. An entry is declaratory in nature when obtaining a right *in rem* is possible on grounds of law or on the basis of a decision of an entity, and when entry into the Land Register is not a condition for obtaining such a right.

iii Choice of law

If an international element exists (e.g., the parties originate from different countries) the parties can agree on the use of applicable law pursuant to Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I).[4] Note that for areas not regulated by the above Regulation, the Private International Law and Procedure Act[5] still applies.

II OVERVIEW OF REAL ESTATE ACTIVITY[6]

The continued rise in the number of sales in the real estate market in 2017 confirmed that the revival of market in 2014 marked the end of the Slovenian real estate market crisis. While prices of residential real property hit bottom in 2015, last year they increased to such an extent that there was a turnaround in prices in the Slovenian real estate market. In 2018, continued rise of real estate prices is expected.

According to the information from the Surveying and Mapping Authority of the Republic of Slovenia, around 17,200 real estate transactions in the total amount of €1.07 billion were concluded in the first half of 2017. The positive economic conditions and climate

4 Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I).

5 Private International Law and Procedure Act (Official Gazette of Republic of Slovenia, No. 56/99 with amendments).

6 The information provided in this paragraph is taken from the reports on the real estate market in Slovenia for 2016 and the first half of 2017 prepared by the Surveying and Mapping Authority of the Republic of Slovenia, available at: http://www.e-prostor.gov.si/index.php?id=etn&no_cache=1&tx_simpltabs_pi1[tab]=590#tab5-970 (last visited on 1 December 2017).

continue to stimulate growth in the demand for real estate. This applies mainly to residential real property and construction land. The main factors influencing the growth in demand for residential real property include low interest rates for residential loans, the decrease in rate of unemployment, the rise of salaries and the fall in prices of flats during the crisis. The demand for construction land has increased because of the greater interest of potential investors in building new residential units for the market. Considering the relatively positive economic conditions, low interest rates and increased interest in investing in real estate, there has also been an increase in sales of commercial real estate. In the first half of 2017, there were 49 transactions with commercial real estate at a purchase price higher than €1 million.

The year 2017 also represented the beginning of a new construction cycle in Slovenia, as supply will try to follow increased demand. The stock of new apartments built during the crisis has almost been emptied and cannot satisfy the increasing demand for new flats. Almost no new large buildings, neither residential nor commercial buildings, are on the market.

In past years, there was also no negative effect on the supply of used residential real estate, which was expected owing to the implementation of a new Energy Act[7] that stipulates that real property owners must submit an energy card to buyers upon purchase or to list the basic energy indicators when advertising the property, or this effect was counteracted as sales grew from year to year.

III FOREIGN INVESTMENT[8]

Under the Slovenian Constitution, foreigners are able to obtain an ownership right on real estate in the Republic of Slovenia under conditions that are set either by law or by an international treaty ratified by the National Assembly of the Republic of Slovenia.

It should be noted that citizens and legal entities established in a country that is a member of the European Union,[9] Organization for Economic Cooperation and Development or the European Free Trade Association, as well as persons with Slovenian status, who are not Slovenian nationals, are eligible to obtain real estate under the same conditions as citizens of the Republic of Slovenia.

For natural and legal persons coming from countries that are not included in the above categories, the condition of reciprocity must be met for obtainment of ownership right over real estate in Slovenia, and a special proceeding to determine the existence of reciprocity would have to be carried out in accordance with the Reciprocity Act.[10] In case of a lack of reciprocity, obtaining ownership on real estate in Slovenia would be denied. Pursuant to the Reciprocity Act, reciprocity exists if a Slovenian citizen or legal entity may acquire ownership rights over real estate in the country of the foreigner under the same or similar conditions than those under which foreigners may acquire ownership rights over real estate in Slovenia,

7 Energy Act (Official Gazette of Republic of Slovenia, No. 17/14 with amendments).

8 The information provided in this paragraph is taken from the official Ministry of Justice website, available at: http://www.mp.gov.si/si/delovna_podrocja/direktorat_za_civilno_pravo/sektor_za_civilno_pravo/pridobivanje_lastninske_pravice_tujcev_na_nepremicninah_v_republiki_sloveniji/ (last visited on 1 December 2017).

9 If a foreigner is from a country that is a candidate for entry into the European Union, the condition of reciprocity must be met and a special proceeding to determine the existence of reciprocity for an individual to obtain real estate is carried out by the Ministry of Justice.

10 Reciprocity Act (ZUVza-1), (Official Gazette of Republic of Slovenia, No. 27/17).

and if the requirements for a Slovenian citizen or legal person meeting these conditions are not essentially more demanding than the requirements applying to foreigners under the Slovenian law.

Special rules apply in the case of foreigners inheriting real estate in the Republic of Slovenia with regard to the principle of reciprocity. Furthermore, reciprocity does not need to be determined in cases when a foreigner is already a co-owner or a joint owner of the respective real estate.

An alternative possibility is ownership of real estate through a corporate entity. As an entity established in Slovenia, it is possible to own real estate, notwithstanding the above conditions.

IV STRUCTURING THE INVESTMENT

Generally, the investment structure depends on several factors, the first and foremost of which is the purpose of the investment. Should the investment be used for business purposes, the (foreign) investor usually chooses to set up a local company or branch and loan finance the acquisition of real estate (as an asset deal). Such special purpose vehicles (SPVs) are especially used for commercial real estate and development projects on a bigger scale. In line with EU directives, dividends are not subject to withholdings, subject to certain conditions. Although the supply of buildings a is generally VAT exempt, the parties may opt for VAT and avoid paying real estate transfer tax (RETT), which is a final cost and, unlike VAT, cannot be refunded. Note that either VAT or RETT needs to be settled to register a change in ownership with the Land Registry.

SPVs are used also in cases when real estate already forms a part of an existing enterprise and is sold as a going concern. Note, however, that such transactions are outside the scope of VAT, and RETT is due.

If the real estate is acquired as an investment, then it is generally purchased by a foreign entity directly because, owing to an omission in Slovenian corporate tax legislation, there is no tax on gains on the sale of real estate by entities that are not tax-residents of Slovenia and do not have a permanent establishment in Slovenia. Similarly, gains on the sale of shares in real estate companies by entities that are not tax-residents of Slovenia and do not have a permanent establishment in Slovenia, are not subject to Slovenian taxation.

Debt push-down structures are not commonly used in Slovenia because of issues with deductibility of interest following mergers between holding companies and real estate companies.

V REAL ESTATE OWNERSHIP

i Planning

Various pieces of legislation and municipality acts regulate the planning of buildings, their construction and use. As a general piece of legislation, the Construction Act (ZGO-1)[11] provides for different types of building and conditions that must be fulfilled for such types and their use. Restrictions on building and development differ across individual spatial planning documents. A Municipality Spatial Plan (OPN) is a framework document of the

11 Construction Act (ZGO-1) (Official Gazette of Republic of Slovenia, No. 102/04 with amendments).

municipality that determines the spatial allocation of the construction lands. Detailed spatial arrangement with regard to a certain area is more specifically regulated by the Municipality Detailed Spatial Plan (OPPN), which must comply with the higher ranking spatial document (i.e., the OPN).

Construction, reconstruction and removal of a building can only commence once a building permit has been obtained and finalised. Notwithstanding the latter, an investor can also commence work on the building once the building permit has been obtained but not yet finalised. Building a simple building or construction can be started without obtaining a building permit.

Change of use requires a building permit to be obtained and finalised, with the exception of change of use of simple works, one-dwelling buildings and other exceptions as provided by law. The building can only be used after obtaining a use permit, unless it falls under the exceptions as provided by the ZGO-1. Building and use permits are issued by the competent administrative unit.

ii Environment

The Environmental Protection Act (ZVO-1)[12] provides a general 'polluter pays' principle (i.e., the polluter is responsible for eliminating the source of excessive burdening of the environment and its consequences). As subsidiary responsibility, the Republic of Slovenia or the local authority must eliminate the consequences of the source of excessive burdening of the environment and bear the costs of mitigating damage that cannot be attributed to any particular or identifiable responsible polluter, or when environmental damage cannot be otherwise remedied.

Furthermore, Slovenia also implemented the Environmental Liability Directive (ELD),[13] which introduced a new chapter on responsibility for prevention and sanitisation of environmental damage including the pollution of land. The polluter is responsible for prevention of further direct risk arising from any environmental damage and prevention or clean-up of the environmental damage, notwithstanding the fact that the damage may not have been the polluter's fault. ZVO-1 provides a list of main activities for which this responsibility is provided and the exceptions. In such cases, the polluter is required to pursue preventive measures to contain any existing risk and sanitisation measures to remedy any existing damage. Furthermore, informing the Ministry is also required. The costs are to be covered by the polluter. Pursuant to Article 110i of ZVO-1 a statute of limitations of 30 years is provided. Nevertheless, the mentioned regime is not applicable to environmental damage caused by an emission, event or incident that took place before 26 July 2008 or to damage caused after that date that derives from a specific activity that was carried out and finished before that date.

iii Tax

Acquisition of real estate is subject either to RETT or to VAT. VAT may only be applied if the seller is a taxable person, registered for VAT purposes. Therefore, the sale of building land or buildings (regardless of their age) by non-taxable individuals will always be subject to RETT.

12 Environmental Protection Act (ZVO-1) (Official Gazette of Republic of Slovenia, No. 39/06 with amendments).

13 Environmental Liability Directive (Directive 2004/35/CE from 30 April 2004, et al.).

In the case where a taxable person sells building land, the VAT is applicable automatically. Similarly, where a taxable person sells new buildings (up to two years of use), VAT is applicable automatically. After the initial two years of using the building, the transaction would be VAT exempt and RETT would apply. However, under certain conditions, the parties may opt for VAT instead of RETT. Usually this option is taken to avoid paying RETT, which is not refundable.

Where VAT is charged upon the supply of building land or new buildings (under two years of use), the straightforward VAT mechanism applies (the seller accounts for VAT on the invoice). However, where the parties have opted for VAT instead of RETT (for non-building land and buildings older than two years), the buyer will perform a VAT reverse-charge upon acquiring such building land or building.

VAT is currently 22 per cent, but a 9.5 per cent VAT rate applies for specific categories of real estate (e.g., social housing).

If the option for taxation with VAT instead of RETT is applied, a special statement has to be submitted to the Tax Authority by each party, in electronic form through the eTax portal. The deadline for submitting this statement is by the end of the month, following the month of supply.

RETT is set at a flat rate of 2 per cent of the real estate purchase price. In the event that the purchase price is more than 20 per cent lower than the market value determined in accordance with the Real Property Mass Appraisal Act, RETT is payable on 80 per cent of the market value as provided by the Act. The liability to pay the tax falls on the seller; however, the obligation may be contractually transferred to the buyer.

RETT is usually paid by the seller; however, the parties may contractually agree to transfer the RETT obligation to the buyer.

Generally, a tax liability for RETT is created at the moment the contract is concluded (provided that the contract subject is real estate). The application for taxation must be submitted to the competent tax authority within 15 days after the conclusion of the contract, and the tax needs to be paid within 30 days from the date at which the taxable party received the notice concerning the tax assessment.

Further tax duties or exemptions are provided by law, such as duties in the event of change of purpose of the real estate, exemptions in the case of inheriting, transfer of ownership on the basis of a deed or gift, etc.

iv Finance and security

In the case of financing with loans, borrowers most typically choose a mortgage to obtain the required security. The most common type of a mortgage agreement is in the form of a notarial deed that can be enforced directly, without filing a lawsuit. For a mortgage based on a legal transaction to be valid, it has to be entered in the Land Registry under the property that is provided as security.

Other commonly used types of security available under Slovenian legislation include an assignment of claims, a personal or corporate guarantee, a bank guarantee, bills of exchange, an agreement on liquidated damages, an insurance policy provided by an insurance company, an ownership right reservation clause, a repurchase agreement, leasing, fiduciary transfer of ownership and other securities.

VI LEASES OF BUSINESS PREMISES

The lease of business buildings and business premises is regulated by the general provisions on lease provided in the Code of Obligations (OZ),[14] and by the Act on Business Buildings and Business Premises (ZPSPP).[15]

The lease of a business building and business premises must be agreed upon in writing, otherwise it is considered invalid. The lessee can use the rented premises solely for the purpose stated in the contract. The use must be exercised with due care.

The lease can be agreed for either a definite or an indefinite period, and the nature of the period agreed upon affects the manner of the termination of the contract. If the contract was agreed upon for an indefinite period, the termination of such a contract is done through the courts. The contract agreed upon an indefinite period expires with the lapse of the termination period, whereby the minimum termination period is one year. The contract agreed for a definite period lapses automatically after the time for which the contract was agreed. The contract concluded for a definite period will be considered as renewed as a contract for an indefinite period, if the lessee continues to use the business premises and the lessor does not demand the eviction of the lessee from the building premises by the competent court within one month after the lapse of this time. Furthermore, notwithstanding the aforementioned provisions, the lessor retains the right to rescind from the contract and demand the eviction of the lessee from the building if: (1) even after being warned by the lessor the lessee continues to use the premises in contravention of the contractual provisions or without the requested care such that serious damage is done; (2) the lessee is late with payments two months after being warned by the lessor; and (3) the lessor cannot use the premises in which he or she exercises his or her own business, through no fault on the lessor's part, and requires the premises for this purpose.

The ZPSPP does not provide any provisions regarding rent, the determination of which is subject to personal decision and rental market conditions.

If not agreed otherwise, the lessor is obliged to execute repairs required on the premises, whereas the lessee is obliged to inform the lessor of required maintenance and to give an appropriate amount of time for these works to be executed. If the lessor does not execute the works in the time required, the lessee can personally take care of the maintenance or resign from the contract. In each case, the lessee is entitled to claim damages for harm suffered on account of the negligence of the lessor.

VII DEVELOPMENTS IN PRACTICE

The real estate sector in Slovenia is expected to face some changes with the entry into force of the new Construction Act[16] and new Spatial Management Act[17] that were adopted on 24 October 2017 and will apply from 1 June 2018. Pursuant to the new legislation, with respect to constructions with environmental impact procedures for obtainment of building permit and environmental approval will be merged into one unified procedure; building permits will no longer be required for the demolition of buildings and temporary

14 Code of Obligations (OZ) (Official Gazette of Republic of Slovenia No. 97/07).

15 Act on business buildings and business premises (ZPSPP) (Official Gazette of Republic of Slovenia No. 18/74 with amendments).

16 Construction Act (GZ) (Official Gazette of Republic of Slovenia, No. 61/17).

17 Spatial Management Act (ZUreP-2) (Official Gazette of Republic of Slovenia No. 61/17).

constructions; and greater activity of construction supervisors during the construction is foreseen. The new Construction Act also provides a fast-track procedure for issuing a building permit, a prerequisite of which is submission of consents given by all persons that have a status of party (e.g., owners of neighbouring land plots), positive opinions on conformity with applicable legislation, confirmation about payment of public utilities charges for the municipal structure and other required documentation.

Under the new Construction Act, obtainment of use permit will be required for all constructions, with the exception of simple constructions, whereas currently the use permit is not needed for one-dwelling residential buildings, simple and non-complex constructions. The investor will be able to replace the use permit with the statement of building designer, head of construction or construction works contractor. However, this alternative option will not apply to complex objects and constructions with an impact on the environment, for which obtainment of use permit will be still obligatory. Before applying for a building permit, the investor will also have the possibility of obtaining a preliminary decision on conditions for intended construction and on compliance of planned construction with applicable spatial planning acts, which will help the investor to decide if construction on the subject land plot or plots is feasible or not.

An additional novelty that comes with the new Construction Act is the obligation of the investor to notify the competent administrative authority and inspector about the start of construction works (eight days before the actual construction begins). Notification must be sent in writing, using a special form that will be prepared by the competent ministry. It shall be accompanied by detailed design documentation and other documentation required for particular types of construction. The new Construction Act also provides for different options of legalisation of non-problematic illegal constructions.

The new Spatial Management Act will replace existing spatial legislation, consisting of several different laws, and represents a comprehensive suite of different mechanisms for effective spatial management. It also provides for a new level of spatial management –regional spatial plans – that will be applicable on a regional level. Municipal spatial plans will not be obligatory for all municipalities anymore, but only for urban municipalities. For those municipalities that will not adopt a municipal spatial plan, spatial planning will be regulated by regional spatial plan. For many municipalities, that also means a reduction of costs intended for the preparation of spatial plans.

Moreover, the new Spatial Management Act introduces a new concept of a building land plot, representing the land under the building that shall be determined in the procedure for obtainment of a building permit. The concept of 'building land plot' was designed to ensure that the current as well as eventual future owner of the building would be able to use appertaining land not only at the time of its construction, but also during the entire existence of the subject building. New legislation also provides for better judicial protection against spatial planning. Each person that will be directly affected by a newly adopted spatial plan will be able to bring an action before the administrative court. The court will have the power to annul or repeal unlawful provisions of the challenged spatial planning act, and to order the competent authority to remedy illegality of the spatial planning act.

To sum up, new legislation is expected to ensure more rational and shorter procedures for obtainment of permits, easier conciliation of different (public and private) interests, greater legal safety for investors, more effective supervision of construction works and better spatial management.

VIII OUTLOOK AND CONCLUSIONS

In the area of real estate valuation, the new Real Property Mass Valuation Act has been adopted in December 2017 and will apply from 1 August 2019.[18] New legislation shall renew the system of property mass valuation by providing better evaluation models and improving the quality of data on real estate. With the use of new evaluation models, generalised market values that are currently attributed to real estate will be better adapted to the actual value of real estate by taking into account special circumstances of the particular real estate. Based on the new Real Property Tax Act, new evaluation of real estate should take place in 2019. In some cases, the new Real Property Mass Valuation Act may have an impact on the calculation of RETT, as a different valuation of real estate may result in a different basis for the calculation of tax. It is also intended that new Real Property Mass Valuation Act shall represent a basis for property tax. However, since the adoption of Real Property Tax Act is not expected during the current government's mandate, new property tax will not be in place before 2020.

In general, Slovenian law regarding immovable property is stable and the land registration system is of a high standard and offers transparency with regard to the data on real estate ownership. Real estate in Slovenia will therefore remain an attractive object for those striving for a stable investment in the long term.

Considering the current economic situation in Slovenia and demand on the real estate market, investments in real estate as well as real estate prices are expected to rise. Furthermore, there has been a significant increase in the construction of residential and hotel buildings, with a focus on the Ljubljana market.

18 Real Estate Property Mass Valuation Act (ZMVN-1) (Official Gazette of Republic of Slovenia, No. 77/17), available at: http://imss.dz-rs.si/imis/859f0d2905b1e33daddd.pdf (last visited on 22 January 2018).

Chapter 31

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 titleholder absolute rights to transfer, use and encumber real estate.

Spanish law also recognises other types of ownership and 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 ownership 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 they allow 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; and

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 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 they are very rarely used in commercial transactions.

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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 the execution of notarial transfer deeds, because they are the only documents suitable for recording the transfer in the Land Registry. Although registering notarial transfer deeds with the Land Registry is not compulsory, it is advisable, as registration grants protection to good-faith third-party purchasers who acquire title from a registered owner in exchange for consideration.

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, below), there are no significant costs.

Transactions with no actual transfer of ownership (i.e., conditional sales subject to conditions precedent) are usually 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, below). 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

Investors have maintained their value-added strategies. However, the focus is gradually moving towards near-prime assets and good assets in secondary locations and cities where the economic recovery is taking hold. This basically means that purchases in the main areas of Madrid and Barcelona have been gradually giving away to investment deals in near-prime locations, as well as in cities such as Valencia, Bilbao and Seville, among others. The main assets sought in these cities and their areas of influence are shopping centres with strong potential, logistics, office and high street retail assets

All in all, 2017 has proved to be an excellent year for the real estate market. Although all sectors have attracted the interest of investors, hotels and offices have been the star assets class as shown in the table below.[2]

	2017	2016	Var (%)
Offices	€2.68 billion	€1.62 billion	65.4
Hotels	€2.40 billion	€1.36	76

2 As of 30 September 2017. Source: Laborde Marcet as published by economic journal *Cinco Días*.

	2017	2016	Var (%)
Retail	€3.36 billion	€2.74	36
Logistics	€1.15 billion	€1.04	9.5

On the selling side, 2017 has seen the major banks offloading assets they accumulated on their balance sheets. For instance, Banco Popular sold to Blackstone 51 per cent of part of its real estate business that includes real estate assets and non-performing loans (NPLs) for €5.1 billion and BBVA has sold has sold the bulk of its Spanish real-estate business to US private equity group Cerberus for €4 billion.

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, below). The acquisition or incorporation 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 or issued. The purpose of this filing is to record 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 acquiring more than 50 per cent of the Spanish SPV's share capital, 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 as indicated above.

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).

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 European Union, provided that it complies with the substance, business purpose and beneficiary ownership tests) 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, below) and not to non-recoverable transfer tax. The Spanish SPV will be subject to Spanish CIT, generally at a rate of 28 per cent or 25 per cent,[3] on its net income (including, by way of example, rental income and capital gains derived from the transfer of a property). Interest (with certain limitations established in Spanish law), amortisation and expenses are generally deductible if they are linked to the company's business activities and transfer pricing rules are complied with.

ii Share deals

Share deals were traditionally 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 was subject to non-recoverable transfer tax (payable by the purchaser) at a rate of between 2.5 and 11 per cent over the market value of the property (depending on the region in which the real estate is located).

However, that is no longer the case and pursuant to the new drafting of Article 314 of Royal Decree 4/2015, of 23 October 2015, approving the revised Securities Market Law, only transfers of shares intended to avoid the payment of taxes applicable on the transfer of real estate will be subject to transfer tax or VAT. In relation to this, the Law presumes that there exists the intention to avoid payment of the indirect taxes applicable to the transfer of real estate in the following cases:

a when, as a consequence of a secondary market transfer of shares, control of a company (defined as an equity stake higher than 50 per cent) is acquired and the company's assets consist of at least 50 per cent of real estate assets located in Spain that are not linked to a business or professional activity, or if, following the change of control, the purchaser's stake in the company increases;

b when, as a consequence of a secondary market transfer of shares, control of a company is acquired and the securities forming part of the company's assets allow control over another entity with assets comprising at least 50 per cent of real estate assets located in Spain not linked to a business or professional activity, or if, following the change of control, the purchaser's indirect stake in the company increases; or

c when there is a transfer of shares and the transferred securities have been received in exchange for contributions-in-kind of real estate assets upon the incorporation or share capital increase of a company, provided that the real estate assets are not linked to a business or professional activity and no more than three years have elapsed between the contribution date and the transfer date.

The above are rebuttable presumptions. Therefore, if any of them is met, the Spanish tax authorities do not need to prove the intention to avoid taxes. Conversely, taxpayers are also entitled to evidence the absence of an intention to avoid taxes even if the transactions carried out fall under any of the presumptions. It is worth clarifying that the tax authorities are not precluded from evidencing the existence of an intention to avoid indirect taxes in potential scenarios other than those covered by the above-mentioned presumptions.

Note that if the transfer of shares is subject to tax (i.e., because the anti-avoidance clause applies), it will be subject to VAT or transfer tax, depending on the tax that would apply to the direct transfer of the real estate assets owned by the company whose shares are being transferred (and not always to transfer tax, as established under the former regime).

3 Pursuant to Law 27/2014, of 27 November, on Corporate Income Tax (the CIT Law), the general corporate income tax (CIT) rate was set at 28 per cent in 2015 and at 25 per cent from 2016 onwards.

iii Sale of the property

Profits generated 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, and are subject to the general Spanish CIT rate (i.e., 28 or 25 per cent).[4]

V REAL ESTATE OWNERSHIP

i Planning

In Spain, the autonomous regions have exclusive competence for planning matters (except for some very basic aspects that lie in the hands of the central government). Spain has 19 different regional 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 central government 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 commercial properties 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, which vary depending on 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.

4 See footnote 2.

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, if an activity classified as potentially polluting (as listed in Annex I to Royal Decree 9/2005) has been carried out on a piece of land, such circumstances must be declared by the owner in the public deed of transfer and thereafter be recorded 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 relevant regional government.

iv Tax

VAT and transfer tax

As a general rule, the first transfer of non-residential properties by sellers in the course of their business activity is subject to VAT at a rate of 21 per cent; first transfer of residential properties is subject to VAT at a rate of 10 per cent.

Second and subsequent transfers of built and finished properties by sellers in the course of their business activity are, however, technically subject to but exempt from VAT, and thus subject to transfer tax at a rate that ranges between 2 and 11 per cent of the purchase price (depending on the autonomous region where the property is located and the tax benefits applicable). The VAT exemption can be waived by the parties when the seller and the buyer are VAT registered and the purchaser is entitled to a total or partial 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 critical, 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 sunk cost for the acquirer, and waiver of the VAT exemption should be sought.

If the VAT exemption 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 execution of the transfer deed if the transfer of real estate is subject to and not exempt from VAT, in which case stamp duty will be levied at a rate of between 0.25 and 2 per cent, depending on the autonomous region in which the real estate is located. If the transfer is subject to but exempt from VAT and the exemption is waived, stamp duty will be levied at a rate between 0.25 and 2.5 per cent per cent, depending on the autonomous region in which the real estate is located.

Stamp duty is paid by the acquirer. Stamp duty is also paid on many other occasions, including the creation of mortgages and certain other charges in the Land Registry, at a rate that ranges between 0.25 and 1.5 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 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. RET will only be due if the cadastral value of the real estate is assessed and formally notified to the taxpayers. Municipalities are in need of cash and lately have been devoting substantial resources to assessing and quickly updating the cadastral value of real estate.

The RET rate for urban real estate depends on the relevant municipality regulations and ranges between 0.4 and 1.1 per cent of the cadastral value.

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, pledges of receivables held or to be held by the borrower, such as the lease rent, insurance compensations, VAT refund rights and pledges over the borrower's shares).

Mortgages are the preferred and most commonly used security interest. Mortgages are security interests that 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 ranging between 0.25 to 2 per cent of the maximum amount secured by the mortgage (typically 130 to 140 per cent of the loan principal).

VI LEASES OF BUSINESS PREMISES

Freedom of contract governs lease agreements for business premises. The only exceptions to this general principle are matters 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 or large unit in a shopping centre 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 and the landlord must deposit it with the competent authority. The lease bond cannot be reviewed (upwards or downwards) during the first three years. From the fourth 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 that 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. According to the CIT Law, the applicable rate for the leasing of Spanish business premises is 28 per cent in 2015, and 25 per cent from 2016 onwards.

VII DEVELOPMENTS IN PRACTICE

Several European firms that specialise in student halls of residence have moved into the Spanish market, and have started to develop small portfolios. A number of positive factors that have contributed to growing interest in this particular type of asset:

a a 90 per cent increase in the number of private universities since 2000;

b the fact that Spanish universities are beginning to expand globally, by offering bilingual degree courses in Spanish and English; and

c a steady rise in the number of international students attending Spanish universities.[5]

On the other hand, given the ageing population, the improved quality of life and life expectancy, coupled with the older population's high purchasing power, investors are also starting to invest in homes for elderly offering medical and high-end care services.

VIII OUTLOOK AND CONCLUSIONS

Based on economic and employment growth forecasts, in 2018, demand for offices will still gain positive momentum and we will see greater interest in new retail developments or even the transformation of certain retail areas in cities such Madrid and Barcelona. Capital is seeking out opportunities via new developments, capital expenditure deployment and refurbishments on older offices, shopping centres, hotels and logistics units. Direct investment will also aim

5 Savills Market Report.

at alternative assets such as car parks and student and senior housing. As for the residential sector, it is expected that both residential investment and housing construction will continue to consolidate the positive growth of 2017.

Spanish banks will continue to offload assets (mainly NPLs that require high levels of equity) to clean up their balance sheets, and the opportunistic investors that entered the market in 2010 are now seeking exit. It is therefore expected that the level of activity in the years to come will remain high and at least at the levels observed in 2016.

Chapter 32

SWEDEN

Jan Berg and Carl-Magnus Uggla[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

Real estate is most commonly held by way of freehold, which is an unrestricted ownership (in terms of the right to occupy and dispose of real estate) manifested by registration in the Swedish Land Register. Certain restrictions are applicable to freeholds with regard to the right to develop land and construction of or materially changing the look or function of buildings. The government guarantees the accuracy of the Land Register, which is kept by the Land Registration Authority.

A common form of tenure is the site leasehold, which is a usufruct whereby investors may hold government- or municipality-owned real estate against an annual fee. Site leaseholds are generally treated as freeholds when it comes to the right to occupy, develop and dispose of the leasehold and using the leasehold as collateral by registering mortgages in it. A site leasehold is usually granted for long periods of time, up to 60 years, unless longer periods are agreed between the parties. Shorter periods are allowed when it comes to non-residential real estate. However, the fee may be reviewed every 10 years unless otherwise agreed in the leasehold agreement.

ii System of registration

A new owner of real estate (whether in the form of a freehold or a site leasehold) is required by law to submit an application to attain a title deed with the Swedish Mapping, Cadastral and Land Registration Authority. The application needs to be submitted within three months from completion of the acquisition of the real estate. It is required to provide the Land Registration Authority with the original deed of transfer together with the application. The physical or legal person registered as owner with the Land Registration Authority has the right and ability to take action involving the property, apply for mortgages, decide rights of use, etc. Failure to apply for a title deed within the three-month time-limit does not affect the validity of the acquisition, however, the Land Registration Authority has the right to order an application under a penalty of a fine. Corresponding requirements apply to acquisitions of site leaseholds.

As stated, the Swedish government guarantees the accuracy of the Land Register and is liable to compensate any loss or damage caused by faulty information in the register. For this reason, there is no need for or availability of title insurance in Sweden.

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iii Choice of law

Sweden is a member of the European Union (EU), and is therefore bound by the Rome I Regulation (Regulation (EC) No. 593/2009 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations). The general rule is that a contract is governed by the law chosen by the parties. If the parties to a contract have not made a choice of law, contracts regarding the right *in rem* to or the tenancy of real estate shall be governed by the law of the country in which the real estate is situated (*lex rei sitae*). However, if the contract has a manifestly closer connection with another country, the law of that country shall govern the contract.

II OVERVIEW OF REAL ESTATE ACTIVITY

i Real estate activity

In terms of transaction volume in the Swedish market, 2016 proved to be a record year. In 2017, transaction activity remained high but did not reach the levels of 2016 in terms of volume, and there is talk of a slowdown in the market. There has been a particular focus on some segments such as real estate with construction rights (local plans in place) and retail.

Interest from foreign investors in the Swedish market continues to be high and is motivated by the fact that the Swedish market is considered safe compared to other markets, is characterised by a robust and transparent system and simplicity in terms of transaction processes and agreements, and has for a long time proven to provide liquidity for investors.

In the latter part of 2017, the market saw tendencies to a down-turn in the private residential market owing to worries of higher interest rates and new regulations for amortisation on loans entering into force. This, in turn, has affected developers of residential real estate aimed primarily at the high-end market, who have been decreasing their portfolios of development real estate.

ii Legal factors

In January 2017, a new regulation regarding investment aid for student housing and housing for rent entered into force. The regulation provides the opportunity to receive investment aid for the development of real estate for new student housing and housing for rent after 1 January 2017. The regulation is a direct consequence of the current housing shortage in Sweden, and is expected to increase construction in the long term.

The Swedish government issued an official report in March 2017 that contained a proposal stating that if a real estate holding company was subject to a change of control because of a tax-exempt sales of shares, the company itself would be taxed as if it had sold and purchased the actual real estate at fair market value. The proposal came under very heavy criticism and was not included in the budget for 2018. There are currently no indications that the proposal will ever be enacted, but it still serves as an an indication of political will to increase the tax burden for the real estate sector.

Historically, it has been beneficial, and consequently common, to transfer real estate held by a physical person to a limited liability company as a gift. Provided that remuneration paid by the company did not exceed the tax assessment value, the transaction was deemed to be a gift and did not trigger any tax. As of 1 August 2017, a property is deemed to be divested, and taxed accordingly, if it is transferred towards remuneration exceeding the tax base value.

See Section VIII, below, for further discussion regarding anticipated legislation and proposals for reform.

iii Social factors

In spite of significant development projects in recent years the general consensus is that there is a shortage of particularly low-cost housing in and near to Sweden's main cities, especially Stockholm. Politicians have been promising significant increases in development of residential real estate, however, the reality is that current rent control legislation, permission processes for development projects, the cost of meeting current requirements on residential buildings and the shortage of resources in the construction industry will make these targets impossible to meet in practice.

III FOREIGN INVESTMENT

There are no restrictions on foreign investors owning or registering title to real estate in Sweden. However, it is still common practice for foreign entities to establish limited liability companies in Sweden through which real estate will be held.

IV STRUCTURING THE INVESTMENT

Investments in commercial real estate are generally made as indirect investments through special purpose holding companies. This is, in part, to avoid real estate transfer tax when divesting the property (see Section V.iii, below), but the main reason for an indirect holding is to ensure that capital gains upon a transfer of the real estate (indirectly through the transfer of the shares in the holding company) are tax-free for the seller (see below).

The special purpose holding companies most commonly used are Swedish limited liability companies. Such companies are formed through registration with the Swedish Companies Registration Office. A limited liability company is represented by a board of directors and in some cases a managing director. At least half of the board of directors and the managing director must be residents within the European Economic Area (EEA). If none of the representatives is resident in Sweden, the company must authorise a person resident in Sweden to receive service of process on behalf of the company. The liability of the shareholders in a limited liability company is by default limited to the company's share capital and it is very rare for the corporate veil to be pierced in Sweden (whereby the shareholders would be directly liable for a limited liability company's debt and obligations).

Another form of legal entity that is sometimes used for owning real estate is a limited partnership. However, limited partnerships are currently not as common or advantageous from a tax perspective as the use of limited liability companies. See below for a more elaborate discussion on the most common investment vehicles.

i Acquisition vehicles and acquisition financing

Local Swedish acquisition vehicles are usually established as limited companies. The acquiring company is normally financed through a combination of equity, external loans and shareholder loans. Sweden does not have thin capitalisation rules, so generally equity is kept fairly low. Interest deduction limitations rules may, however, limit the tax deduction of interest paid to affiliated companies. It should also be noted that there is currently a proposal to introduce a form of earning stripping rules (see below).

The acquisition vehicles and the target company are often merged post-completion of an acquisition in order to get the acquisition financing into the target company holding the real estate and thereby making it possible to *inter alia* use the real estate as collateral for the financing. Should the initial structure be left intact, however, the financing costs may still be set off against taxable income in the target or real estate holding company in subsequent years, using group contributions with fiscal effects.

ii Interest deductions

As mentioned, there are currently no formal thin capitalisation, earnings stripping or formal debt-to-equity rules in the Swedish tax system. Shareholder loans and debt-to-equity ratio, may thus be used to provide for tax optimisation through interest deductions and flexibility in moving cash upstream.

Compulsory liquidation will, however, be triggered under the Swedish Companies Act should the equity of a company fall below 50 per cent of the registered share capital, unless the equity is restored to an amount corresponding to at least the entire registered share capital. Hence, it is often recommended to keep the registered share capital limited compared to the market value of the company containing real estate or to the free equity of the company.

Interest accrued on third-party loans is generally tax deductible provided the interest is not related to profits or distribution of profits. Interest between affiliated parties must be at arm's length to be deductible. Interest paid between affiliated companies that are in excess of an arm's-length interest rate is not tax deductible to the extent it exceeds the arms'-length interest rate. Provided the interest on intercompany loans is properly benchmarked and documented, interest costs are normally deductible.

There are interest deduction limitation rules in Sweden covering all intercompany loans between affiliated companies and interest costs on such loans. Put simply, expenses related to such loans will only be tax-deductible if the beneficial owner of the interest is taxed at a level of at least 10 per cent, and provided that the loan was not predominantly put in place for tax reasons; or the beneficial owner of the interest is an EEA resident, and the loan was predominantly put in place for business reasons.

On 20 June 2017, the Swedish government introduced a proposal containing earnings stripping rules and several other changes in the corporate taxation area. The main proposals contain a general provision limiting the deductibility of net interest expense to 35 per cent of earnings before interest and taxes (EBIT). The proposal also contains an alternative where, instead, the deductibility of net interest expense would be limited to 25 per cent of earnings before interest, taxes, depreciation and amortisation (EBITDA). As compensation for these harsher rules, it is also suggested that the corporate income tax rate is reduced from 22 per cent to 20 per cent. It is proposed that most of the new provisions would enter into force on 1 July 2018, though it is more likely to happen by 1 January 2019.

iii Pre-exit restructuring

Put simply, a real estate holding company may transfer real estate to a subsidiary (including a newly formed company or acquired shelf company) at a price equalling the lower of the tax assessment value and the tax base value, without any adverse income tax consequences. Such a transfer will, however, trigger a real estate transfer tax (see Section V.iii, below). The subsidiary can subsequently be divested without any tax consequences.

iv Divestment

A divestment of real estate is subject to capital gains taxation. For corporate entities the tax rate is generally 22 per cent.

There is a capital gains tax exemption for Swedish corporate entities on gains related to the disposal of shares 'held for business purposes'. Shares in Swedish corporations and participations in partnerships (as well as in foreign companies) can qualify as shares held for business purposes, and thus be divested tax exempt. The rules are applicable also for real estate owning companies, but not for construction companies or companies holding estate as current assets.

V REAL ESTATE OWNERSHIP

i Planning

Planning control is mainly the responsibility of the municipalities in Sweden. The municipalities draw up comprehensive plans and local plans. A comprehensive plan covers the entire municipality and stipulates the long-term development of the land but is not legally binding. A local plan is a legally binding document and regulates more specifically how a particular land within the municipality shall be used. A local plan is, for example, required for new densely built areas and new buildings that may have a greater impact on their surroundings. A local plan is of significant importance for the ability to grant permits.

Most developments and change of use of real estate require a permit. The responsibility for granting permits lies with the local building committee in each municipality. A building permit is, among other things, required for new buildings, extension of existing buildings and change of use of existing buildings. Furthermore, a demolition permit is required for demolition of whole or parts of a building and a ground permit is required for excavation and filling that affects the ground level.

ii Environment

The liability for contaminated land is primarily based on the 'polluter pays' principle, which essentially means that the operator who caused or contributed to the contamination is responsible for investigating and remedying the damage caused by the contamination.

A real estate owner may be liable in a subsidiary manner for damage caused by contamination if the liable operator cannot be found or is unable to remedy the damage. However, such liability is only imposed if the real estate owner knew of, or should have discovered, the contamination at the time of the acquisition of the real estate (and only applicable on acquisitions effective after 1 January 1999).

iii Tax

Sweden levies a real estate transfer tax (stamp duty) on most transfers of real estate. Most legal persons pay 4.25 per cent; natural persons and tenant owner associations pay 1.5 per cent tax on a base that consists of the higher of the consideration paid and the tax assessment value of the real estate. Real estate transfer tax on an intragroup transfer of real estate may usually be deferred provided the real estate, the buyer and the seller remain in the same group. Real estate transferred through a merger, a demerger or real estate reallotments are currently not subject to real estate transfer tax.

In respect of real estate, deductions for depreciation of buildings are allowed at various rates between 2 and 5 per cent annually, depending on the type of building. Land is a non-depreciable asset.

iv Finance and security

The most common form of security granted over real estate is the pledge of mortgage certificates taken out in real estate. The registered owner of real estate has the right to take out mortgages on the real estate. An application to take out mortgages is made with the Land Registration Authority. Taking out a mortgage is subject to 2 per cent stamp duty based on the face value of the mortgage. When the application is approved, a mortgage certificate in electronic or physical form is issued that evidences the mortgage. In order to perfect a pledge over a mortgage in real estate, the pledgee must be registered as the holder of the electronic mortgage certificate in a register with the Land Registration Authority, or in the case of a paper mortgage certificate, take physical possession of the certificate.

It is furthermore common to pledge the shares in a special purpose real estate holding company. Such pledges are perfected by the transfer of share certificates to the pledgee, or, in the event that no share certificates have been issued, through noting the pledge in the company's share ledger. Examples of other forms of security are business mortgages, pledges of IPR such as trade names and pledges of balances in bank accounts.

VI LEASES OF BUSINESS PREMISES

i Term

The term of a lease is, in general, freely negotiable between the parties and may be indeterminate or determinate. The maximum lease term is 50 years for premises located in non-planned areas and 25 years in planned areas. If the lease term is indeterminate, there is a legal requirement to ensure a minimum notice period for termination of nine months. If the lease term is determinate, the law requires the parties to ensure certain minimum notice periods as well; for example if a lease term is longer than nine months, the minimum notice period is nine months.

The grounds for forfeiture are fixed by law. The landlord has, for example, the right to terminate the lease early if the tenant:

a does not pay rent;
b subleases the premises or transfers the lease without necessary approval; or
c materially neglects the premises.

Furthermore, the tenant under a commercial lease has an indirect right of tenure (see below), while a tenant under a residential lease has a direct right of tenure.

ii Rent

As a general rule, the rent must be fixed in the lease agreement if the lease term is less than three years. However, costs for heating, cooling, warm water, electricity or VA do not need to be included in the fixed rent. The rent may also be based on the tenant's turnover or on a written agreement concluded between the landlord and an organisation of tenants. If the lease is longer than three years, another basis for calculation of rent is allowed, for example tying the rent to an index such as the Consumer Price Index.

iii Tenant liability

A tenant's main responsibilities under the Tenancy Act are as follows:

a A tenant is responsible to pay rent.

b A tenant may only use the leased premises as intended and as stated in the lease agreement unless the landlord gives its approval for a change of use. If the landlord does not give its approval, the regional rent and tenancies tribunal may grant the tenant permission to use the premises for another purpose if the tenant has leased the premises for more than two years and has considerable reasons for change of use, and the landlord does not have reasonable grounds for opposing such change.

c A tenant is responsible to take care of and maintain the premises and liable to compensate the landlord for any damage caused by the tenant. The parties may agree on more extensive responsibilities for the tenant, with respect to maintenance.

d A tenant is not allowed to use the premises in a way that may disturb or damage the health and living environment of people living in surrounding areas. A tenant is furthermore responsible to preserve order and soundness within the premises and to keep the premises in a good condition.

e A tenant is generally not allowed to transfer a lease or sublease without the landlord's approval. However, transfers may be permitted if the business operation that has been conducted in the premises is also transferred and the regional rent and tenancies tribunal gives its approval to the transfer. With regard to subleasing, the tenant may, if the landlord has denied the tenant permission to sublet the premises, apply to the regional rent and tenancies tribunal to get the denial overruled provided that the tenant can show that the landlord has unreasonably withheld its approval.

f A tenant is generally responsible to reinstate the premises to an acceptable condition at the expiry of the lease term (however, this is not explicitly regulated by law).

As stated above, most of these liabilities may constitute grounds for forfeiture if they are neglected by the tenant.

iv Security of tenure

Tenants to commercial leases have an indirect right of tenure, which secures a right to compensation for the loss of the lease if the landlord terminates and refuses to renew the lease, or if the landlord as a condition for renewal requires lease terms that are not in accordance with the market standard and the tenant cannot accept such terms and therefore decides to leave the premises. The compensation shall cover a minimum of 12 months' rent.

However, the tenant does not have the right to such compensation:

a if the tenant has neglected its responsibilities under the lease agreement;

b if the premises shall be demolished and the landlord provides other acceptable premises;

c if the premises shall undergo essential reconstruction and the landlord provides other acceptable premises;

d if the landlord has reasonable ground for refusing renewal; or

e if the landlord's terms for renewal are reasonable.

The tenant may waive its right to compensation. Such waiver requires a separate written agreement between the parties, and, if the lease has been in force for less than nine months when the waiver is provided, the parties need approval from the regional rent and tenancies tribunal.

VII DEVELOPMENTS IN PRACTICE

i A housing bubble?

The private residential market has been and continues to be in focus. There is talk of a bubble, and concerns related to the level of household borrowings. In late 2017 and the beginning of 2018 regulations have and will be entering into force, making amortisation on residential loans mandatory. In conjunction with this, in late 2017 prices for private residential real estate took a bit of a downturn. The decrease in demand for (at least high-end) residential apartments has, in turn, had effects on what has most likely been a slightly overestablished residential developer market. We will most likely see a consolidation in this market and have already seen developers divesting parts of their development portfolios in order to focus on ongoing projects.

ii Coming tax reforms

The debate around whether the real estate sector in general is undertaxed or not has been ongoing for quite a while now. There are many unknowns related to coming tax reforms (highlighted elsewhere in this chapter) that are likely to have a dampening effect on the market.

iii Digitalisation

In general, the real estate sector has so far been quite protected from any major disruption, with the exception of the hotel industry with the entrance of Airbnb. Looking forward, the office market should be facing similar disruption owing to increasing demand for flexibility from tenants looking for possibilities to quickly increase as well as decrease leased space. New business models based on co-working spaces and spaces as a service are coming, but are held back to some extent by traditional business models and ultimately tenancy laws that are not designed to accommodate these changes. In effect, this means that the era of long and stable cash-flows in the office segment may be over, which in turn will have implications for traditional valuation models.

The consistent growth of e-commerce is likely to continue to negatively affect the market for retail real estate, at the same time as having positive effects for logistics real estate.

Finally we see a lot of new technology (proptech) coming into the real estate industry, and considerable sums being invested in companies looking to disrupt the industry in various ways such as solutions for management of buildings and tenants, smart buildings, energy efficiency, platforms for add-on services that may be offered to tenants, etc.

VIII OUTLOOK AND CONCLUSIONS

i Anticipated legislation and proposals for reform

As discussed above in Section II, an official report was presented in March 2017 (SOU 2017:27) suggesting a new proposal regarding taxation of property packaging. The proposal has met heavy criticism and it is currently not likely that it will be enacted. If the government, however, decides to propose the enactment of new legislation, it is expected to have significant effects on the Swedish real estate market.

Another official report was presented in April 2017 (SOU 2017:33) suggesting measures to strengthen the position of tenants. The suggested measures include, among other things, to increase the landlord's duty to inform its tenants of planned renovations or refurbishments of premises, and to increase the influence of tenants over such decisions and to restrict the possibilities for a private landlord to terminate a lease (suggested to enter into force on 1 July 2018). The government has not proposed new legislation as of yet, but the proposals in the official report have been criticised and the enactment of new legislation would likely decrease the amount of renovations of apartment buildings and lower the interest to own and invest in residential real estate.

As discussed above in Section IV, in June 2017, the Finance Department presented a memorandum suggesting new taxation rules for the corporate sector. The main proposal constitutes a general provision limiting the deductibility of net interest expense to 35 per cent of EBIT. The proposal is partly based on Council Directive (EU) 2016/1164 of 12 July 2016, laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

In November 2017, the Swedish financial supervisory authority proposed a stricter amortisation requirement for households with high loan-to-income ratios. The proposal suggested that any new loans granted to borrowers where the total loans become greater than 4.5 times the borrower's gross income would require amortisation of at least 1 per cent of the debt in addition to the already existing amortisation requirements. The government approved the proposal on 30 November 2017 and the new amortisation requirements are expected to enter into force on 1 March 2018.

Chapter 33

SWITZERLAND

Andreas F Vögeli and Oliver Zbinden[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

Under Swiss law, different types of real estate ownership exist. The most common forms of ownership are sole ownership[2] and co-ownership. A special – and in Switzerland predominant – form of co-ownership is the condominium-principled co-ownership. Its main characteristic is that different persons own separate units in a common property or, as the law puts it, condominium is a form of co-ownership of immoveable property that gives the co-owner the exclusive right to make sole use of specific parts of a building thereon and design the interior of such parts. Each condominium owner can manage, use and design the structure of their units as they wish but must not obstruct any other condominium owners in the exercise of their own rights or damage the common parts of the property. Importantly, each unit has its own folio in the land register and may be sold separately without the consent of the other co-owners, who have no statutory right of pre-emption.

Further property rights include:

a usufructuary rights – a contractual arrangement where the owner confers complete enjoyment of the object on the usufructuary;

b right of residence – the right to live in all or parts of a building; and

c building rights[3] – the ownership of the ground is dissociated from the ownership of the constructions.

One major difference between a usufructuary right and the right of residence is that the latter can only be granted to individuals but not to legal entities.

A lease contract, if entered in the land register, provides a similar legal position to the beneficiary as the aforementioned rights *in rem*. The effect of such entry is that every future owner, in principle, must allow the property to be used in accordance with the lease.

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2 Often also referred to as freehold or land ownership as the sole owner usually owns the land and its integral parts and everything built on it.

3 Compared to the freehold the owner of a building right is not owner of the land but only the holder of a leasehold right encumbering that land. He is granted a right to erect and maintain a building on the underlying lot.

ii System of registration

Every (privately owned) piece of land, including individual condominium units, has its own folio in the land register, where title information (ownership, size and description of the property), easements, usufructs and other servitudes, charges, lien and mortgages, notes (typically public law restrictions) and priority notices (e.g., contractual pre-emption rights, lease agreements) are recorded.

Title to real estate is transferred to the new owner exclusively by way of entry in the land register. The ownership cannot be transferred as long as the purchaser is not entered into the land register. The prerequisite for registration is a notarised purchase contract constituting the legal ground for acquisition of ownership or any other rights *in rem* on real property. Only such notarised contracts can be entered into the land register.[4]

There is a legal presumption that federal land register entries (but not entries in cantonal registries in the few locations where the federal land register is not yet fully introduced) are true and correct. Every person that relies on the land register in good faith is therefore fully protected. The content of the land register prevails over the factual circumstances as long as good faith is given. Furthermore, the land register establishes the presumption that the registered rights exist. Therefore, title insurance is neither needed nor known.

iii Choice of law

Rights *in rem* on real property are exclusively subject to the law of the place where the real property is located. In principle, contracts concerning real property or its use are also governed by the law at situs; however, a choice of law by the parties is permitted. In any case, the form of the contract is governed by Swiss law if real estate in Switzerland is concerned.

Due to the notarisation requirement, Swiss law is generally chosen by the parties to a real estate transaction as governing law.

II OVERVIEW OF REAL ESTATE ACTIVITY

After 14 years of price growth in the residential property sector until stagnation in 2015 and even a drop in 2016, there is now again a noticeable upward trend in prices for condominiums and single-family homes.[5] However, unlike the residential property sector, there is no upturn in sight regarding the rental accommodation market; the downturn that set in 2016 has continued in 2017. The negative interest environment prevailing for over three years and the investment crisis resulting from this are driving the construction of rental apartments to

4 Notary law is cantonal; therefore the notarisation process may differ from canton to canton. Generally, only notaries at the place of the property are competent to notarise real estate purchase contracts. An exception to this is the special case of a transfer of assets under the Swiss Federal Act on Mergers: Under this Act, in case of certain forms of restructuring of legal entities, all assets, including real estate, are transferred by entry of the corresponding contract in the Commercial Register.

5 See Credit Suisse, Swiss Real Estate Market 2017, available at https://www.credit-suisse.com/ch/en/articles/private-banking/schweizer-immobilienmarkt-studie-2017-201703.html, p. 4; wüestpartner, Immo-Monitoring 2018 I 1, p. 10.

very high levels, despite the fall in demand due to lower immigration. At the end of 2017, vacancies in the rented accommodation sector reached a record level in Switzerland. Tenants increasingly benefit from lower rents.[6]

As far as the commercial property sector is concerned, although the situation eased for some investors in 2017, office market conditions remain difficult: asking prices are falling. However, construction of offices is still rising. As for retail premises, retail turnover is suffering greatly from online retailing. A ray of hope comes from consumer spending, which is expected to rise. Furthermore, cross-border shopping should start to decline following the appreciation of the euro. The number of construction permits for retail premises has increased in the past six months.[7]

All in all, real estate investments have remained very high up in investors' favour in 2017. Although the yield spreads to alternative investments have passed their peaks, demand for 'concrete gold' has remained robust due to the negative interest rates, particularly among institutional investors. There was simply a lack of alternatives to solve investors' yield problem without excessive risk.

III FOREIGN INVESTMENT

The purchase of real estate by foreign investors, in particular of residential properties, as well as foreign mortgage financing of residential properties is restricted by the Swiss Federal Act on the Acquisition of Real Estate by Persons Abroad (the Lex Koller) and the respective ordinance. The Lex Koller requires that foreign investors – EU/EFTA nationals without permanent residence in Switzerland and nationals of other countries without a C permit – must apply for authorisation when acquiring residential properties in Switzerland. In practice, authorisations for residential properties are difficult to obtain. They may be granted, for example, for the purchase of a holiday home based on a yearly defined quota in touristic (alpine) regions.

No authorisation is required if the property is used for commercial purposes (e.g., offices, shopping centres, retail, hotels, restaurants). If this is the case, it is irrelevant whether the property is used for the buyer's business or rented or leased by a third party in order to pursue a commercial activity. The property may also have land reserves if they – as a rule – do not exceed one-third of the total surface of the land.

The purchase of undeveloped land needs an authorisation even if it is in a commercial or industrial zone except when work on a building that will be used for commercial purposes has already started or will start within a short time.

At the latest after the conclusion of the real estate purchase contract, the foreign investor must request authorisation for the transaction or determination that no authorisation is required for the respective acquisition. The authorisation may be granted with conditions and restrictions in order to ensure that the property is used in accordance with the purpose stated by the foreign acquirer.

6 See Credit Suisse, Swiss Real Estate Market 2017, available at https://www.credit-suisse.com/ch/en/articles/private-banking/schweizer-immobilienmarkt-studie-2017-201703.html, p. 4; wüestpartner, Property Market Switzerland 2017 I 4, available at https://www.wuestpartner.com/publications/immobilienmarkt%20schweiz%202017%20i%204_3, p. 2.

7 See wüestpartner, Property Market Switzerland 2017 I 4, available at https://www.wuestpartner.com/publications/immobilienmarkt%20schweiz%202017%20i%204_3, p. 4.

IV STRUCTURING THE INVESTMENT

Traditionally, investments in real estate were made by acquiring specific properties directly or through a legal entity established for that purpose. Given the recent growth of the real estate investment products market, a general trend towards indirect investments can be observed. The advantages of indirect investments are low transaction costs, high liquidity, broad diversification and a lower entry level compared to direct investments.

The main types of indirect real estate investment vehicles are real estate funds,[8] non-regulated investment companies limited by shares, which must be either listed or only accessible to qualified investors, Swiss real estate investment foundations, and special purpose vehicles (SPVs). Real estate funds may be established in the form of contractual investment funds, SICAVs (investment company with variable capital), KGKs (limited partnership for collective capital investments) or SICAFs (investment company with fixed capital).

Contractual investment funds, SICAVs and standard SPVs are the most common investment vehicles. In addition, real estate investment companies and real estate investment foundations have become quite popular in recent years. Depending on the investor's corporate structure, SPVs may offer a number of advantages. Real estate investment trusts (REITs) and real estate derivatives are typically not set up in Switzerland and may be subject to regulatory requirements and restrictions if distributed in Switzerland.

The contractual investment fund is a contract based on a collective investment agreement under which the fund management company commits itself to investors in accordance with the number and type of units which they have acquired in the investment fund, and to manage the fund's assets in accordance with the provisions of the fund contract at its own discretion and for its own account. The fund management company draws up the fund contract and, with the consent of the custodian bank, submits it to FINMA for approval. The fund management company's share capital must at least be 1 million Swiss francs (paid up in cash), and the investment fund must have net assets of minimum 5 million Swiss francs.

SICAVs are, in principle, established under the provisions of the Swiss Code of Obligations. They are not allowed to begin operations before obtaining FINMA's authorisation, which includes all constitutional documents. The most important authorisation and approval requirements are: assets of at least 5 million Swiss francs, the company's name must contain a description of its legal form or the abbreviation 'SICAV', the ratio of company shareholder deposits to total assets must be appropriate, company and investor shares which do not have a nominal value and are freely transferable must be fully paid up in cash, a custodian bank must be designated, the SICAV must choose to be either self-managed or externally managed and must hold a defined quantity of equity capital. SICAVs are usually listed on the Swiss stock exchange, which alleviates certain Lex Koller burdens.

KGKs are limited partnerships with the sole object of collective investment. They must be authorised by FINMA and their constitutive documents approved. At least one member (general partner) bears unlimited liability. The other partners (limited partners) are liable only up to a specified amount. General partners must have paid-in capital of a minimum of 100,000 Swiss francs and limited partners must be qualified investors.

A SICAF is a company limited by shares with the sole object of collective investment. It must seek FINMA authorisation and have its constituting documents approved as well. Its shareholders are not required to be qualified investors and it is not listed on a Swiss stock

8 See the SXI Real Estate Funds Index for the real estate funds listed on the SIX Swiss Exchange.

exchange. Essential features of a SICAF are that it only manages its own assets and generates returns or capital gains without engaging in business activities as such. The minimum deposit on foundation must be at least 500,000 Swiss francs, fully paid up.

In general, the costs for each type of entity used to invest in real estate vary depending on the volume and the structure of the vehicle. How a foreign investment is structured in a particular case is usually determined by tax considerations.

V REAL ESTATE OWNERSHIP

i Planning

Zoning laws are based on a Federal Act, but the implementation is on the cantonal and communal level. Building regulations are mainly enacted by the cantons and implemented by the municipal building authorities, which leads to significant regional differences. Change of use, particularly of residential premises into commercial ones and vice versa, is heavily regulated and increasingly restricted.

In general, new buildings or any changes to existing buildings require a permit by the competent local authority. They must be planned and designed in a way that they render a harmonious overall impression, both individually and taking into account the surrounding area. Special building regulations may help to facilitate the planning of major projects. Additionally, dimensions and distances stipulated in the regulations must be observed. Furthermore, a variety of special regulations (e.g., on fire and earthquake safety) needs to be complied with.

Once the planning application is submitted to the competent municipal authority, it publishes the project in the local official gazette. All parties affected by the project, primarily owners of neighbouring buildings, have the right to raise objections against it. If the municipal building commission finds that the project is in accordance with all applicable regulations and all objections are settled, a building permit is issued. It is key that the finalisation of the project does not deviate from the specifications set out in the building permit, otherwise the authority may order the removal of the illegal structures of the construction.

Buildings and land under cultural heritage protection as well as nature conservation or agricultural areas underlie strict regulations; new constructions and renovations must therefore be carefully planned.

ii Environment

Swiss environmental law differentiates between the polluter who actually caused the pollution and the owner of the property. Primarily, the person causing the pollution must bear the costs of remediation. If the polluter cannot be called upon to bear the costs, the remediation costs remain with the cantons and partly with the owner of the land. Hence, the buyer of real estate may also be held responsible for environmental issues, particularly soil pollutions.

Polluted real estate is registered in the cadastre of contaminated sites and may only be transferred with the approval of the competent cantonal authority, which may order that potential future costs of remediation be secured.

iii Tax

The transfer of real estate is subjected to land registry and notary fees. Additionally, transfer taxes may apply depending on the canton (Zurich and Zug, for instance, do not levy transfer taxes). The rates range between 1 and 3.3 per cent of the purchase price. It is common for the parties to a real estate purchase contract to agree to share the real estate transfer taxes as well as the land registry and notary fees, even if most cantonal regulations provide that the buyer must pay them.

Further, the seller must pay real estate capital gains tax if a gain is realised by the transfer of the property. The capital gains tax, the amount of which largely depends on the duration of the ownership, varies from canton to canton. The range of applicable rates is therefore large and may vary between 10 and 60 per cent. In most Cantons the payment of the tax is secured by a public-law mortgage right on the property. Hence, a purchaser must be certain that the seller pays the tax.

Additionally, an individual using a property as his or her own residence is annually taxed on a deemed rental income (known as imputed rental value). On the other hand, maintenance and financing costs relating to the property may be deducted, which may even outweigh the imputed rental value.

iv Finance and security

Swiss real estate is usually financed by a mix of own and external funds. The standards applying to real estate financing by Swiss banks provide that 10 per cent of the value of the property, as valued by the bank, must be paid down in cash as well as any difference between the value and the actual (usually substantially higher) purchase price. Banks additionally require security for another 10 per cent of the property value. Borrowers must further amortise their mortgage debt down to two-thirds of the property's lending value within 15 years.

Buyers and owners of real estate in Switzerland are free to raise external financing from lenders abroad. The granting of a security over a mortgage note does not entail problems under the Lex Koller as long as the terms of the security are at arm's length and do not aim to circumvent the provisions of the Lex Koller. In practice, institutional investors often hold significant real estate portfolios that are financed without external funding. But also a mix of own funds and external debt in form of a secured term loan and a revolving credit facility is common.

External real estate financings are primarily secured by security interest (in the form of an ownership transfer for security purposes or a mortgage) of mortgage notes. The creation of a (registered or bearer) mortgage note provides an independent claim in the mortgage note's amount and is separate from the claim under the credit documentation (i.e., the loan). The mortgage loan claim is secured by the underlying property.

VI LEASES OF BUSINESS PREMISES

Two main types of purely contractual lease arrangements exist; the traditional lease and the usufructuary lease. Both types are governed by the Swiss Code of Obligations. The traditional lease is more common in Switzerland, both for residential and business premises in the retail, hotel, office and industrial sector. Usufructuary lease is typical in the agricultural and the gastronomy sector.

The law only sporadically differentiates between the lease of commercial and residential properties. Notable differences are the minimum notice periods (three months for residential and six months for commercial premises) and the security furnished by the tenant (in a residential lease, the landlord may not ask for more than three months' rent by way of security; in a commercial lease, there is no such restriction). A large number of Swiss tenancy law provisions are mandatory in order to protect the tenant, who is *per se* considered to be the weaker party, which is obviously often not the case with commercial tenants. However, also commercial lease contracts may only be negotiated within the limits of mandatory tenancy law.

Lease contracts may be limited or open-ended. Parties to open-ended lease contracts usually agree that they can terminate the contract subject to a six or 12-month notice period. Yet, typically, commercial leases are concluded for a term of five to 10 years, with the option to extend the lease for one or more similar terms. Landlords usually seek five-year lease terms because it offers the possibility to adapt the rent to the Swiss consumer price index. An agreement to link rent to the Swiss consumer price index is not valid where the lease is contracted for less than five years. In addition, banks financing commercial real estate often require that part of the mortgage or loan is repaid before the lease terminates. At the same time, long-term lease is particularly attractive for tenants developing the property for their specific needs (at their own expense), since it is common not to claim reimbursement for the investments from the landlord at the end of the lease.

Extension options can be designed in different ways. Usually tenants favour options where the conditions of the rent, in particular the rental price, remain, while landlords prefer options that offer the possibility to adapt the rent at the end of the lease term to the new market price.

In both limited and open-ended leases, the parties are free to choose a certain lease model. Typically, the rent is fixed and will only be revised if the contractually agreed rent calculation basis changes (e.g., the Swiss consumer price index, reference interest rate) or if the landlord provides additional services. The parties may agree on a staggered rent or a turnover or sales-based rent instead – usually combined with a guaranteed minimum rent. The law only forbids clearly excessive rents, which is not the case if the rent falls, for example, within the range of rents customary in the district, if it is justified by increases in costs or by additional services provided by the landlord or if it does not exceed the range of gross pre-tax yield required to cover costs in the case of a recently constructed property. However, in certain circumstances, the rent amount can also be challenged by the tenant after the conclusion of the rental agreement.

While the rent for residential leases is almost always paid monthly in advance, it is not uncommon for parties to commercial leases to agree on quarterly payments. Most commonly, the rent is secured by a security deposit, which is paid by the tenant before the lease starts. The deposit provided in the form of cash or negotiable securities is deposited on a bank account in the tenant's name. The bank can release such security only with the consent of both parties or in compliance with final payment or final court decision. Alternatively, bank guarantees can also serve as a security. If the tenant neglects to pay the rent, the landlord is allowed to terminate the lease contract after having set the tenant a final deadline for payment.

A security of tenure does not exist in Switzerland. Nonetheless, the tenant may request the extension of a fixed-term or open-ended lease where termination of the lease would cause a degree of hardship that cannot be justified by the interests of the landlord. The lease may be extended by up to six years for commercial premises. In practice, extensions of more than two years are rarely granted in the greater Zurich area.

VII DEVELOPMENTS IN PRACTICE

There have been a number of recent revisions to the regulatory framework impacting the real estate market.

On 1 May 2017, both the revised Waters Protection Ordinance and the revised Contaminated Sites Ordinance entered into force. The former particularly gives the cantonal authorities greater freedom in defining the spaces provided for waters. According to the latter, the concentration values of ammonium and nitrite in the groundwater do not need to be considered any more when assessing the need for remediation of a polluted site. As a consequence, according to the Federal Office for the Environment, remediation cost savings of a total of 60–80 million Swiss francs are expected.

Further, the parliament mandated the Federal Council to change land registry ordinance, so that the owner of the ground can see who has been making requests about his or her land through the electronic land register. Therefore, the land registry ordinance will be changed in the near future.

In March 2017, the Federal Council of Switzerland opened a hearing procedure for the amendment of the Lex Koller, the law restricting the acquisition of real estate by persons abroad. The Federal Council proposed that authorisation be required for the acquisition of main residences in Switzerland by nationals of non-EU/EFTA states with a C permit. The proposed authorisation would always be linked to the obligation to resell the dwelling within two years of giving up residence in Switzerland. Shares in housing cooperatives, however, would be acquirable by these persons without an authorisation, if the acquisition of shares is necessary for the rent of such a dwelling. Controversial questions in practice would be clarified and the procedure for establishing authorisation requirements would be shortened, according to the proposals of the Federal Council.

The Federal Council also put up for discussion very severe restrictions, in particular whether commercial properties (e.g., offices, factories, logistics, shopping centres, hotels) should, as a rule, be subject to the Lex Koller again, repealing the corresponding liberalisation of the Lex Koller that was enacted in 1997. Foreign investors would thus be excluded from acquiring commercial properties in Switzerland in the future. The only exception would be where owners use the properties for their own business activities and do not lease the property to third parties. The Federal Council also put up for discussion whether the acquisition of shares in a legal entity, the real purpose of which is the acquisition of real estate, should be subject to an authorisation even if these shares are listed on a stock exchange in Switzerland. Only the acquisition of shares in a SICAV would be exempt.

The hearing procedure closed at end of June 2017. The proposals and the restrictions put up for discussion faced heavy opposition from many political parties, organisations and from the real estate industry. Therefore, it is not clear at this time whether or what changes the Federal Council might propose to the parliament.

Currently, the Swiss Federal Law on Public Procurement is revised. The main objectives are to reflect the multilateral agreement on public procurement between the member states of the World Trade Organisation, as well as to harmonise the procurement regulations of the Swiss Confederation and the cantons. Furthermore, parliament aims to introduce regulations with regard to further reductions of carbon dioxide emissions, the launch of subsidies for energy efficient building restorations and the abolishment of the taxation of the imputed rental value for self-occupied premises. Further legislative work concerns the revision of the Swiss Federal Land Use Planning Law, affecting, for example, hotels outside the building zone. It is not yet possible to forecast when these amended laws will enter into effect.

Recently, a few new real estate investment funds were launched. Moreover, an internet platform-based investment forum for the purchase of co-ownership units was successfully launched.

The markets show that real estate in good locations is rare, expensive and has low yields. As a consequence, investors look for alternative investment possibilities such as real estate development projects. The aim is to still achieve attractive yields.

VIII OUTLOOK AND CONCLUSIONS

As outlined above, real estate investors and developers must deal with a number of laws governing real estate transactions: civil law, environmental law, tax law, etc. In the area of tenancy law, it is key that the parties negotiate lease contracts only within the limits of the mandatory provisions. Since 2016, certain residential real estate transactions are also restricted by the Federal Act on Second Homes, which led to a decrease in real estate projects in some touristic (alpine) regions. It remains to be seen whether the aims of this new legislation – reducing the rents as well the 'cold beds' – will be achieved or, in the worst case, local construction companies and industries will suffer. The Lex Koller restrictions and authorisation regime will continue to apply and may be even tightened. The most far-reaching potential amendment would be that the acquisition of commercial properties is again subject to an authorisation. In our opinion, such a major change in the legal environment, which would affect foreign real estate investors, is rather unlikely.

Despite high real estate prices, investments remain attractive, particularly for institutional investors. There is strong demand for commercial and residential properties in prime locations, and it is unlikely that prices will significantly drop in the near future except for in the retail market. Volatile exchange rates, a strong Swiss franc and the tax policy in the United States will continue to influence foreign investors' investment decisions, though, and may lead to sudden increase or decrease in demand for Swiss commercial real estate.

In summary, the outlook on the real estate market remains stable as investors continue to rely on Switzerland's political and financial stability as well as on continuous economic growth and a robust legal system. However, it is likely to become increasingly difficult to maintain the good performance of the previous years as further capital will be fed into the comparatively high-yielding real estate market that is consistently putting yields under pressure.

Chapter 34

TAIWAN

Yi-Jiun Su and Yi-Li Kuo[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.

Strata titles are fairly common in residential and commercial buildings in urban areas. Taiwan has a strata title system consisting of individual lots and common property. By and large, a person may own a building but only have proportionate ownership of the land jointly with others, and may transfer his or her strata title to a third party without the consent of the other co-owners of the land.

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 (1) the inspection is

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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.
3 Article 758 of the Civil Code.

completed, (2) the occupancy permit is obtained and (3) 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, and 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 (MOI) established a registration system under which (1) the purchaser, land administration agent (i.e., scrivener) or broker (as the case may be) of a real property sale and purchase transaction must register the actual transaction price within 30 days of the completion of the title transfer; and (2) the broker of a lease transaction must register the actual transaction price within 30 days of the signing of the lease agreement.

iii Choice of law

Theoretically, Taiwanese courts will uphold the foreign law chosen to govern transactions involving real property in Taiwan, provided that the application of such a foreign law does not contravene the public policy or good morals of Taiwan. Nonetheless, as Taiwan 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, to avoid any conflict-of-law issues it would be advisable for parties to such transactions to adopt Taiwan 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 in infrastructure projects. In addition, under the PPP Act, the government may assist investors in acquiring land necessary for infrastructure projects.

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.

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

4 Articles 78 and 79 of the Regulations of Land Registration.

5 Article 5 of the Measures on Creation of Superficies over State-Owned Not for Public Use Land, last amended on 30 September 2013.

and mainland China,[6] low interest rates and increased loan availability. Following the implementation of anti-speculative measures, particularly the compulsory registration of and public access to the actual transaction prices of real property implemented by the MOI starting from 1 August 2012 (see Section I, above), it seems that the introduction of a new tax system for real property conveyancing in Taiwan (as further explained in Section IV, below) has, to a certain extent, tentatively cooled down the residential property market in Taiwan.

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 more than a decade 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 as long as the foreign investor meets the following conditions to qualify to purchase real property in Taiwan:

a the jurisdiction where the foreign entity was incorporated or the jurisdiction in which the foreign individual is a national, as the case may be, allows Taiwanese entities and individuals to own real property there (reciprocal treatment);

b the real property to be purchased is not restricted land;[8]

c the real property is purchased for the entity's or individual's own use, investment or public interest, and is used as:
- a residence;
- a place of business, office building, shop or factory;
- a church;
- a hospital;
- a school for children of foreign nationals;
- a diplomatic and consular building or office buildings of organisations for the promotion of public welfare;
- a cemetery; or
- a construction recognised and approved by the authorities as important to Taiwan's major infrastructure, economy, or agricultural or husbandry industry; and

d the prior approval of the city or county government with jurisdiction over the real property has been obtained.

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.

8 The term 'restricted land' covers 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.

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 requires prior approval from the city or county government.

Regarding Chinese investors,[9] 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. For example, Chinese individuals can only obtain the ownership of one unit of building (i.e., the real estate bearing one building number and the land where such building is located) for the purpose of residence and, in principle, cannot transfer the ownership within three years of being registered as the owner. Chinese-entity investors may obtain the ownership of real property only for business needs permitted under the relevant regulations. On 26 November 2013, the MOI promulgated certain control measures aimed at controlling the total volume of Chinese individuals' investment in real estate, which took effect from 2014. For Chinese individuals intending to purchase real estate in Taiwan, such 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 units of the buildings per year, and the unused quota of a particular year cannot be used the next year. In addition, 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 units of the buildings. Furthermore, to prevent Chinese individuals from driving up the purchase price of real property in particular areas, the MOI also introduced a new control measure on 1 July 2015 that capped the number of units that Chinese individuals can own in a single building or community (i.e., no more than 10 per cent of the total units in the same building or community; if the number of the total units is less than 10, Chinese individuals may not own more than one unit). According to statistics published by the MOI, as of 7 November 2017, the overall purchases made by Chinese individuals amounted to 1.9234 hectares and 419 units of the buildings. Although the aforementioned 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. Furthermore, as real estate prices in metropolitan areas in Taiwan have continued to surge since 2009, and with an increasing number of Chinese investors acquiring real estate in Taiwan, the MOI amended the Guidelines on the Approval of the Acquisition, Creation or Transfer of Real Estate Rights by PRC Investors in Taiwan on 9 June 2017 in order to curb real estate speculation by Chinese investors and to stabilise the local real estate market. Among other things, the amendments to the Guidelines stipulate that Chinese investors' applications to acquire, create or transfer real estate rights must be denied in any of the following events:

a Taiwan's major infrastructure might be affected;
b land monopolisation or speculation is suspected;
c the comprehensive development of the national territory might be affected; or
d central competent authorities believe that national security or social security might be compromised.

9 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. Investments by these entities in Taiwan are limited to certain businesses.

IV STRUCTURING THE INVESTMENT

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 will vary from investor to investor 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, while institutional investors purchase real property for capital gains and rental income. Both can 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.

Second, in a case of ownership through a branch, a foreign entity may purchase real property in Taiwan if it has established a Taiwan branch. Unlike a subsidiary, however, a branch, as an extension of the foreign entity's head office, is not considered to be a Taiwanese entity; as such, the foreign entity, despite having established a branch, must meet the conditions described in Section III, above, to qualify to purchase real property in Taiwan.

Either of these 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.

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 a 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.

Eligibility to purchase real property

As discussed in Section III, above, a subsidiary, being considered a local entity, need not meet the four conditions required for 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, before the implementation of the building and land consolidated tax system described below, 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 on buildings (17 per cent of the net income; capital gains from the sale of land are generally exempt from income tax), land value incremental tax (LVIT) (ranging from 20 to 40 per cent based on the increase in the land value during the period from the purchase to the subsequent sale), deed tax on buildings, VAT on buildings 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.

Despite the foregoing, it is worth noting that the Taiwan government has introduced a new tax system in Taiwan, which came into effect on 1 January 2016. Under the new tax system (i.e., the so-called 'building and land consolidated tax system'), the seller's total capital gains from the sale of the following land or buildings are subject to income tax: (1) buildings or land acquired after 1 January 2016; or (2) buildings or land acquired after 1 January 2014, and owned for no more than two years prior to sale. In addition, the tax rates that apply to non-Taiwan residents or foreign entities are different from those that apply to Taiwan residents or entities headquartered in Taiwan. For non-Taiwan residents or foreign entities, the tax rates would be: (1) 45 per cent for buildings or land owned for no more than one year prior to the sale; and (2) 35 per cent for buildings or land owned for more than one year prior to the sale. Since the increased tax rate of the new tax system for capital gains from the sale of the land or buildings payable by the non-Taiwan residents has been implemented, most foreign investors are inclined to incorporate a company in Taiwan to act as a vehicle to hold the real property in Taiwan for the purposes of tax savings and efficiency.

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 a rate of 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 for 2016 are NT$500,000 and 12 per cent of net income, respectively. 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.

Generally speaking, a transfer of the shares in a foreign entity will not trigger any tax liability in Taiwan. However, following the enforcement of the new tax system described above, for a non-Taiwan entity that directly or indirectly holds more than 50 per cent of the shares or capital of another non-Taiwan entity and no less than 50 per cent of the latter's share value is composed of the buildings or land in Taiwan, the capital gains that the former obtains from the sale of the shares or capital in the latter are subject to the applicable tax rates (i.e., 45 per cent or 35 per cent) under the new tax system.

V REAL ESTATE OWNERSHIP

i Planning

The use of land is subject to applicable zoning rules. In addition, 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 unless the size of the building is under the threshold stipulated by the relevant authorities. Therefore, an investor should check the zoning of the land it plans to purchase and the permitted uses of the building located thereon 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. Furthermore, the remodelling or expansion of the building may also require prior written approval from the authorities. As such, an investor will sometimes engage an architect to conduct an engineering due diligence to check the real property's compliance with the building-related regulations.

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 that have the potential to and are most likely to cause pollution) pursuant to the Soil and Groundwater Pollution Remediation Act (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 (particularly, the property owner, even though it is not a polluter, may still be subject to certain liabilities, no matter whether the contamination concerned is historic or is caused by the migration of offsite contamination), 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 explained above, a land or building owner must pay land value tax or 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 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 and is determined by the local governments within the ranges from 1.2 to 5 per cent of the current assessed value of buildings, depending on their use under the House Tax Act.

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, because of the higher risks associated with commercial properties, the loan-to-value (LTV) ratios offered by commercial lenders in Taiwan are usually between 50 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. In addition, if a lease is entered into after a mortgage is created over the leased property, in the event that the leased property undergoes a court auction proceeding owing to the debtor's default, the court may decide to terminate the lease if it finds that the lease affects the auction of the leased property.

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 leases 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 leases for the construction of buildings, cannot be longer than 20 years,[10] and are generally for five years or longer for commercial properties such as multistorey retail stores and offices, and one year or longer for residential properties. In addition, any real property lease for a period of more than one year must be in writing;[11] otherwise, the lease will be deemed a lease for an indefinite term, which both parties may terminate at will by

10 Article 449 of the Civil Code.

11 Article 422 of the Civil Code.

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.[12]

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.[13]

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.[14]

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 the rent,[15] unless the lease agreement already provides a rent adjustment mechanism.[16] 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 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 their original state; however, tenants that remove the fixtures attached by them to the leased premises should restore the leased premises to their original state.[17] 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 their original state, except for normal wear and tear, or on an 'as-is where-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.

12 Article 451 of the Civil Code.
13 Article 425 of the Civil Code.
14 Article 99 of the Land Act.
15 Article 442 of the Civil Code.
16 Supreme Court judgments No. 86 Tai-Shang-Zi-Di-1613 (1997) and No. 88 Tai-Shang-Zi-Di-287 (1999).
17 Paragraph 2, Article 431 of the Civil Code.

VII DEVELOPMENTS IN PRACTICE

i Residential property market

In terms of 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. Housing ownership – especially in urban areas of Taipei – is currently 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. In light of housing price hikes in certain rural areas of Taiwan, the Central Bank of the Republic of China (Taiwan) (CBC) has undertaken a series of targeted precautionary measures since June 2010 to safeguard financial stability, including promulgating regulations related to land collateralised loans and housing loans in areas overheated with real estate-related transactions. Given that such targeted precautionary measures have discouraged speculative demands, on 24 March 2016, the CBC further amended the Regulations Governing Home Mortgage Loans and Land Loans extended by Financial Institutions (later known as the Regulations Governing Home Mortgage Loans for High-Value Housing Extended by Financial Institutions). Under the amended Regulations, most rules (such as the LTV ceiling) imposed on home loans and land loans are repealed, except for high-value housing loans. The high-value housing prescribed under the amended Regulations refers to: (1) property in Taipei City valued at NT$70 million or more; (2) property in New Taipei City valued at NT$60 million or more; or (3) property located elsewhere in Taiwan valued at NT$40 million or more.

ii Commercial property market

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. The most direct way for insurance companies or foreign equity funds to invest in the commercial property market would be by 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.

VIII OUTLOOK AND CONCLUSIONS

Under the current tax regulations, capital gains from the sale of land are generally exempt from income tax, but are subject to LVIT. However, LVIT has long been underestimated, as the government-assessed value used for calculating LVIT is usually much lower than the actual transaction price. In addition, given that the government-assessed value is adjusted once a year, if the purchase and the subsequent sale both occur in the same year, the amount of LVIT would be zero. Therefore, as explained above, the Taiwan government introduced a new tax system, with effect from 1 January 2016, to combine the tax treatment relating to the sale of buildings and the sale of land by imposing income tax on the total amount of gains as a tax reform to curb speculation in real property.

By and large, under the new tax system, the capital gains from the sale of the buildings and the sale of land, after deducting the increase in the land value (for the purpose of avoiding double taxation) and the relevant cost and expense, are subject to income tax unless any of the statutory benefits apply.[18] As a result, the tax to be borne by the seller under the new tax system is substantially higher than that under the old tax scheme. It is generally believed that the new tax system will, to some extent, impact the development of the Taiwan real estate market. In addition, as the new tax system imposes a much higher rate than before on the capital gain from the sale of real estate by foreign companies, it is expected that most of such companies interested in investing in real estate in Taiwan will, in light of the tax implications, choose to do so by establishing companies in Taiwan (with 'foreign investment approved' status) in the long run.

Furthermore, calculation of the house tax in Taiwan is based on the current assessed value of the building multiplied by the applicable tax rate (e.g., 1.5 per cent to 3.6 per cent for non-owner-occupied residential property). Moreover, the current assessed value of the building is determined by each of the local governments by multiplying 'assessed standard construction costs' by a depreciation value, after multiplying the value by a 'sector adjustment rate' to take into account the value of its location. As the assessed values of buildings are considered to have been under-estimated for a long time, recently most of the local governments have determined to increase the assessed standard construction cost. As a result, the house tax is expected to increase, which means that the cost for holding buildings in Taiwan will increase as well, and in turn this might have a negative impact on the real property market in Taiwan in the long run.

Whether real estate prices in metropolitan areas in Taiwan have been curbed, thereby prompting the government to stop introducing more measures to regulate the residential property market, remains to be seen. 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 Taiwanese 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 the property bubble bursting 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 United States, it is generally believed that commercial property demand, especially in 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 factors could create a more vibrant and dynamic real property market in the next few years.

18 For instance, with regard to the sale of land and buildings that are the registered residence of an individual, his or her spouse or minor children (provided that they actually live in the building for at least six consecutive years and the properties have never been provided for business use or for rent), the net gains under NT$4 million can be exempt from the consolidated land and building sales tax; for the portion of the net gains over NT$4 million, the tax rate is only 10 per cent.

Chapter 35

UNITED ARAB EMIRATES

Iain Black 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.

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). The federal laws set out a number of principles regarding real property and rights relating to it. The Law of Civil Transactions of the UAE (Civil Code)[2] is the primary source. Part 1 deals with the application of laws in the UAE and the types of rights that are recognised. 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).

Each emirate is governed by a ruler (local government). The local government has the power to pass laws for its 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.[3] Each local government has introduced local laws regarding real property and rights relating to it, producing distinct legal and regulatory frameworks at the emirate level.[4]

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 apply within its borders (free zone regulations). To understand the legal and regulatory framework applicable within a free zone, it is necessary to consult the free zone regulations, as well as the federal and local laws that relate to it. The Abu Dhabi Global Market and Dubai International Financial Centre (DIFC), for example, each have their own property laws, register of property rights and forum for hearing disputes.

1 Iain Black is a partner and Joe Carroll is a senior associate at Dentons.
2 Federal Law No. 5 of 1985, as amended.
3 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.
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 principles will be applied.

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 (outside the free zones).

i Ownership of real estate

In the UAE, interests in real property and rights relating to it (property interests) can be characterised as either property rights (such as freehold) or contractual rights (such as leasehold). The most common property interests are as follows:

a freehold: the most complete form of ownership with 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 property for a limited period and to construct buildings thereon (a property right); and

d leasehold: a right to use property for a limited period (a contractual right). Depending on the length of the contractual term, leases are further subdivided into short and long leases.

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 (GCC) (other than the UAE) are subject to some restrictions in respect of Abu Dhabi property rights. Persons falling outside both categories (foreign nationals) are subject to the greatest restrictions. The local government can disapply these restrictions in specific areas. These powers have been used to create investment zones (Abu Dhabi) and freehold areas (Dubai), which are the least restrictive areas for property ownership.

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 and long leases should be registered with the Department of Municipal Affairs (Abu Dhabi Municipality) on its real estate register. The owner will receive a title certificate as proof of ownership.[7] Contracts for properties purchased off-plan should be registered with Abu Dhabi Municipality on its register of off-plan properties. Short leases should be registered with Abu Dhabi Municipality on its register of tenancy contracts (Tawtheeq).[8]

In Dubai, property rights and long leases should be registered with the Dubai Land Department on its real estate register. The owner will receive a title certificate as proof of ownership. Contracts for properties purchased off-plan should be registered with the Dubai

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.

7 To date, limited registration has taken place other than for UAE nationals.

8 There are certain exemptions from the registration requirement, depending on the use to which the property is put.

Land Department on its register of off-plan properties (Oqood). Short leases should be registered with the Real Estate Regulatory Authority (RERA) on its register of tenancy contracts (Ejari).[9]

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 Abu Dhabi's hydrocarbon wealth, Dubai embarked on a massive programme of real estate development to accelerate the diversification of its economy. Abu Dhabi has also taken 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) have grown rapidly. The investment zones (Abu Dhabi), freehold areas (Dubai) and free zones (with their advantageous corporate and tax regimes) have been integral to this development.

Despite the transformation underway in the UAE, the number of foreign institutional investors has remained relatively low. It is fair to say that the pace of growth has been rapid, and legal and regulatory systems have required time to develop and mature. A significant milestone was passed in 2014 with Morgan Stanley Capital International Inc upgrading the UAE and its bourses from frontier to emerging market status.

The global economic slowdown resulted in significant decreases in property prices and rents. As new projects reached completion, so oversupply exerted additional downward pressure. Since this time a combination of factors, including lower oil prices, fluctuations in global currency markets and wider geopolitical challenges, have contributed to suppressed market activity and reductions in government spending, resulting in reduced investment, pressure on wages and redundancies in certain sectors and decreases in property prices and rents.

Further decreases in property prices and rents may continue in 2018, with a particular concern being oversupply as new projects reach completion. Some commentators on the market have expressed the belief that rates of decrease will reduce during this period as the market progresses towards the next phase of the cycle.

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.

III FOREIGN INVESTMENT

There are restrictions on foreign investment in UAE property that vary according to the nationality of the investor and location of the property.[13] The restrictions attach to both natural and legal persons. Since the restrictions are not laid down in federal law, it is necessary to consult the local laws and practices of each emirate.

i Foreign ownership in Abu Dhabi

Foreign nationals, and entities owned in whole or in part by them (foreign entities), can own certain property rights in the investment zones of Abu Dhabi. The available property rights include ownership of apartments and floors in buildings (with no right to the underlying land), usufruct and musataha. The investment zones include projects such as Al Raha Beach, Reem Island and Saadiyat Island.

Foreign nationals and entities can hold leases of property located in the investment zones for a contractual term of up to 99 years. They can also hold leases of property located outside the investment zones but will be limited to a contractual term of 25 years.

GCC nationals, and entities incorporated in the UAE or GCC that are wholly owned by GCC nationals or in part with UAE nationals, can own the same property rights as foreign nationals and, in addition, freehold within the investment zones.

ii Foreign ownership in Dubai

Foreign nationals and foreign entities can own property rights in the freehold areas of Dubai. The available property rights include freehold, usufruct and musataha. The freehold areas include projects such as the Palm Jumeirah, Jumeirah Lakes Towers, Dubai Marina and Downtown Burj Khalifa.

Notwithstanding the above, the Dubai Land Department has implemented a policy that prevents the direct registration of property rights by foreign entities. Instead, it will permit registration by certain locally incorporated entities that have foreign nationals or foreign entities as shareholders. By establishing one of these entities as its subsidiary, to hold title, a foreign entity will be able to acquire the relevant property.[14]

Foreign nationals and entities can hold leases of property located in the freehold areas for a contractual term of up to 99 years. They can also hold leases of property located outside the freehold areas but will be limited to a contractual term of 10 years.

In Dubai there is no distinction between UAE and GCC nationals. They can own any of the recognised property interests throughout Dubai. However, entities incorporated in the GCC will be subject to the requirement to establish a locally incorporated subsidiary to hold title.

Finally, public joint stock companies incorporated in the UAE, irrespective of any shareholders that are foreign nationals, will be treated as UAE nationals and can, therefore, own any of the recognised property interests in Dubai.

13 See Article 298 of Law No. 11 of 1992 (Federal Civil Procedures Law).

14 See Section IV.ii, below.

IV STRUCTURING THE INVESTMENT

Property assets will often be acquired by a special purpose vehicle 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 should be formulated in light of the restrictions on foreign ownership and the requirement to register property rights. 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.[15]

i Asset or share acquisition

If the seller is a company, the purchaser may have the option of acquiring the asset (an asset deal) or shares in the owner of the asset (a share deal). In each case, any restrictions on ownership (for the asset or shares) should be identified. The ultimate structure by which the purchaser wishes to hold the asset should be identified to achieve the most efficient transfer method. This is particularly important in cases where a transfer (including a share transfer) will attract property transfer fees.

ii Abu Dhabi and Dubai companies

Abu Dhabi and Dubai companies encompass those incorporated in Abu Dhabi and Dubai (onshore and outside the free zones) and include limited liability companies and private joint stock companies. Where such a company has foreign nationals or entities as shareholders it will be considered a foreign national and subject to the same restrictions on ownership of property rights.

iii Free zone companies

An Abu Dhabi free zone company can hold rights over property within that free zone and Abu Dhabi's investment zones. A Dubai free zone company can hold rights over property within that free zone and Dubai's freehold areas. A recent change in practice has permitted free zone companies incorporated in the DIFC to acquire property within Dubai's freehold areas (outside the DIFC) without requiring the approval of the Dubai Land Department.

15 Article 26 of Dubai Law No. 7 of 2006.

iv Free zone companies – offshore

A Dubai free zone company (offshore) incorporated in the Jebel Ali Free Zone can hold rights over property within that free zone and Dubai's freehold areas. Other offshore companies cannot register property rights over property located in Dubai's freehold areas.

v Foreign entities

Foreign entities encompass those incorporated outside the UAE, whether onshore in a jurisdiction such as England or offshore in a jurisdiction such as the British Virgin Islands.

A foreign entity can hold any of the recognised property rights over property located in Abu Dhabi's investment zones.

A foreign entity can no longer register property rights over property located in Dubai's freehold areas. The foreign entity will need to establish as its subsidiary one of the locally incorporated entities referred to above to hold title – for example, a free zone company (offshore) incorporated in the Jebel Ali Free Zone.[16]

vi Unregistered leases

Historically, where a foreign national or foreign entity wished to acquire premises for a long term in a location where it was not permitted to acquire a property right, it would enter into a long lease. The suitability of such arrangements has become increasingly uncertain, given the requirement to register all leases and the fact that the foreign national or foreign entity may be precluded from doing so owing to the nationality restrictions. There are also practical consequences of having an unregistered lease (e.g., the local authorities may refuse to issue or renew a company's business licence and utility companies may refuse to connect utilities).

vii Trusted owners

Should a foreign national or entity wish to exercise effective control over a property situated in an area where it is not permitted to acquire a property right, it may consider the trusted owner structure. A UAE national or entity 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 are the authorities primarily responsible for overseeing development, building regulations and planning controls (including change of use) in their respective emirates. Planning permission from the Abu Dhabi Urban Planning Council is required for all strategic developments in Abu Dhabi.

Buildings within an investment zone, freehold area or free zone may also be subject to the regulations and controls of the master developer or regulatory authority for that area.

16 See Section III.ii, above.

Local licensing requirements should also be observed. For example, a developer wishing to establish a new project in Abu Dhabi or Dubai must first register itself and its project with Abu Dhabi Municipality or RERA (as applicable).

ii Environment

Environmental law comprises laws at the federal and local levels and, within the free zones, free zone regulations. 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.[17] They must also undertake an environmental impact assessment for their project.[18]

Because environmental liabilities may pass with ownership of property, a prospective purchaser should consider what diligence and protections are appropriate, such as physical inspection and testing of the land and warranties from the seller in the purchase agreement (against which the seller should disclose any known issues).

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 zone, 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

Historically, no VAT (or equivalent) or stamp duty has been payable on the sale or purchase of real estate in the UAE. It has been announced that the UAE will introduce VAT in 2018 and may introduce corporate tax. See Section VIII, below, for an overview of the new VAT regime. The timeline and contents of the corporate tax regime have yet to be confirmed. Fees are also payable in respect of the registration of property interests.

There may be other costs associated with ownership or occupation. In Dubai, a fee is levied on non UAE residents and business occupiers (5 per cent of annual rent). Hospitality businesses such as hotels must pay a municipality tax (10 per cent of turnover) and per night per room fee (ranging from 7–20 dirhams, depending on hotel category). In Abu Dhabi, a fee is levied on non UAE residents (3 per cent of annual rent, subject to a minimum annual fee of 450 dirhams). Hospitality businesses such as hotels must pay a city tax (6 per cent of turnover) and municipality tax (4 per cent of turnover) and per night per room fee (15 dirhams).

iv Finance and security

Federal law outlines the basic principles regarding the creation of security, including mortgages, over real property. Provided a mortgage is validly created, the mortgagee will acquire a property right and will take precedence over ordinary creditors and creditors subsequent in rank in satisfaction of the debt from the proceeds of sale.

17 Article 3 of Federal Law No. 24 of 1999 for the Protection and Development of the Environment.

18 Article 4 of Federal Law No. 24 of 1999 for the Protection and Development of the Environment.

In Abu Dhabi, a local law and implementing regulations specifically relating to mortgages was introduced in 2016.[19] Historically, actual registration of mortgages reflected the overall registration of property interests in Abu Dhabi (mostly completed by UAE nationals outside the investment zones). Consequently, many funders chose to utilise an unregistered mortgage combined with a conditional assignment of the mortgagor's rights to the property. Should the borrower default, the funder would exercise its step-in rights and take control of the property. This scenario is changing following the introduction of processes for wider registration of property interests in Abu Dhabi.

In Dubai, a local law specifically relating to mortgages was introduced a decade ago.[20] This requires that all mortgages be registered with the Dubai Land Department, that the mortgagee be a bank, company or financial institution licensed and registered with the UAE Central Bank, and that the mortgagor be the owner of the property or property right and able to dispose of it. Actual registration of mortgages is readily available and completed.

VI LEASES OF BUSINESS PREMISES

A common feature of business leases is landlord-friendly terms coupled with resistance on the part of landlords to accept tenant amendments. In the past, with no limits on rent increases or security of tenure, landlords held the upper hand.

Abu Dhabi and Dubai have responded with legislation and institutions (at the local level) to regulate the landlord-tenant relationship in respect of short leases (commonly known as tenancy agreements). The global economic slowdown and challenges currently facing the market have seen landlords increasingly likely to offer inducements and agree amendments to their standard terms.

The following outlines the position in respect of short leases.

i Lease negotiations

The lease registration systems of Abu Dhabi and Dubai have a standard lease template (standard lease). The standard lease can be supplemented with more detailed terms, though these must not contradict any mandatory requirements of the law or the standard lease.

It is common to encounter forms of lease comprising just the standard lease with perhaps one or two additional pages of more detailed terms. Such leases generally address basic terms in a simple manner with negotiations accordingly limited. Leases in prime developments and those requiring more complex terms, such as units in large office buildings and shopping malls, will generally be longer, resulting in greater potential for negotiation of more detailed matters.

ii Term of occupation

Terms of occupation are generally short (commonly between one and five years).[21]

19 Abu Dhabi Law No. 3 of 2015 Regulating the Real Estate Sector in the Emirate of Abu Dhabi and Abu Dhabi Municipality Decision No. 249 of 2015 issuing the Executive Regulations on Mortgages in accordance with Law No. 3 of 2015 Regulating Real Estate Sector in the Emirate of Abu Dhabi.

20 Dubai Law No. 14 of 2008.

21 Rights of musataha (cf. leasehold) should not exceed 50 years but are renewable.

In Abu Dhabi, local law imposes a presumption of renewal but no security of tenure. The landlord is free to terminate the lease at the end of its contractual term, provided it serves the required period of notice. If the landlord fails to serve notice, and the tenant remains in occupation, the lease will renew for a similar term.

In Dubai, local law imposes a presumption of renewal and security of tenure protection for tenants. If the landlord does not establish a permitted ground for opposing renewal, then the lease will automatically renew for the same period or one year (whichever is shorter). A party wishing to vary a term of the lease must serve notice on the other not less than 90 days before 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

In both Abu Dhabi and Dubai, local law limits the maximum increase a landlord can apply (known as the rent cap). In Abu Dhabi, the maximum annual rent increase permitted under the rent cap is 5 per cent of the annual rent. In Dubai, the maximum annual rent increase permitted under the rent cap is 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.

iv Repair

In Abu Dhabi, local law requires that the tenant carry out those simple repairs that, by convention, fall to be carried out by the tenant (unless otherwise agreed by the parties).

In Dubai, local law requires that the tenant return the premises to the landlord in the condition they were in at the beginning of the term, subject to normal wear and tear (unless otherwise agreed by the parties).

In both Abu Dhabi and Dubai, the landlord must carry out those repairs necessary to maintain the structure and ensure the premises are fit for use (unless otherwise agreed by the parties).

v Subletting and assigning the lease

In both Abu Dhabi and Dubai, local laws require the landlord's prior consent before a short lease can be assigned or a subtenancy granted (unless otherwise agreed by the parties).

vi Termination

In Abu Dhabi, local law sets out the grounds on which a landlord can terminate a lease prior to the expiry of its contractual term. At the end of the contractual term the landlord is free to serve notice that the lease will not renew.

In Dubai, local law sets out the grounds on which a landlord can terminate a lease prior to the expiry of its contractual term (such as non-payment of rent by the tenant). Tenants in Dubai enjoy security of tenure at the end of the contractual term, with the law setting out separate grounds on which the landlord may terminate the lease (such as the landlord's right to redevelop).

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 and Dubai – new VAT law

The new VAT law (the VAT law), which introduces VAT to the UAE, will come into effect from 1 January 2018.[22] The key features for the property sector include:

a taxable supplies: the provision of real estate for lease and sale will be a taxable supply;

b rating of supplies: supplies will be rated as:
- exempt, where no VAT is chargeable;
- zero rated, where VAT is chargeable at a zero rate; or
- standard rated, where VAT is chargeable at 5 per cent;

c categories of supply: the VAT law differentiates the main taxable supplies as follows:
- sale of bare land: exempt from VAT;[23]
- sale of residential property: the first-time supply (such as new apartments by developers) within three years of completion will be zero rated.[24] Subsequent supplies (such as onward sales) will be exempt from VAT;[25]
- lease of residential property: the first-time supply within three years of completion will be zero rated.[26] Subsequent supplies will be exempt from VAT;[27]
- sale of commercial property: standard rated;[28]
- lease of commercial property: standard rated;[29] and
- associated supplies (such as service and utility charges): standard rated;[30]

d residential property: does not include hotel or bed and breakfast establishments;[31]

e commercial property: additional considerations include:
- where the term of a commercial lease spans 1 January 2018, VAT will be chargeable from this date notwithstanding the fact that the rent has previously been paid by the tenant;[32]
- where a commercial lease does not provide for VAT, the rent will be deemed inclusive of VAT (with no additional payment required from the tenant).[33] Conversely, if the tenant and the landlord are both registered for VAT, the rent will be deemed exclusive of VAT (with VAT payable in addition by the tenant);[34]

22 Federal Law No. 8 of 2017 On Value-Added Tax (VAT) and Federal Cabinet Decision No. 52 of 2017 On the Executive Regulations of the Federal Law No. 8 of 2017 On Value-Added Tax (VAT).

23 Article 46(3) of Federal Law No. 8 of 2017 On Value-Added Tax (VAT).

24 Article 45(9) of Federal Law No. 8 of 2017 On Value-Added Tax (VAT).

25 Article 46(2) of Federal Law No. 8 of 2017 On Value-Added Tax (VAT).

26 Article 45(9) of Federal Law No. 8 of 2017 On Value-Added Tax (VAT).

27 Article 46(2) of Federal Law No. 8 of 2017 On Value-Added Tax (VAT).

28 Articles 2, 3 and 5 of Federal Law No. 8 of 2017 On Value-Added Tax (VAT).

29 Articles 2, 3 and 5 of Federal Law No. 8 of 2017 On Value-Added Tax (VAT).

30 Articles 2, 3 and 6 of Federal Law No. 8 of 2017 On Value-Added Tax (VAT).

31 Article 37(2)(b) of Federal Cabinet Decision No. 52 of 2017 On the Executive Regulations of Federal Law No. 8 of 2017 On Value-Added Tax (VAT).

32 Article 80 of Federal Law No. 8 of 2017 On Value-Added Tax (VAT).

33 Article 80(2) of Federal Law No. 8 of 2017 On Value-Added Tax (VAT).

34 Article 70(6) of Federal Cabinet Decision No. 52 of 2017 On the Executive Regulations of Federal Law No. 8 of 2017 On Value-Added Tax (VAT). In this event the overall VAT effect for the tenant should be neutral as it should be able to recover the VAT element from the government (against output VAT charged by the tenant).

- a capital assets scheme provides for input tax in respect of buildings to be split over 10 years where a threshold value and other conditions are met;[35]
- the duty to account to the government for VAT vests in the seller or landlord (who will be liable for any shortfall);[36]
- it has yet to be confirmed whether any transfer fees charged by the Dubai Land Department will be calculated on the property's value (price or rent) inclusive or exclusive of any applicable VAT; and
- record-keeping: VAT records must be maintained for a minimum period of 15 years.[37]

ii Abu Dhabi – rent cap

A rent cap (limiting annual increases to 5 per cent of the annual rent) was re-introduced in December 2016.[38] While this change was not expected, given the general softening of rental levels, the additional protection has been welcomed by tenants nonetheless.

iii Dubai – cancellation of off-plan property contracts

The process by which developers can cancel off-plan property contracts has been amended.[39] The key features of the new process are:

a the developer must complete a form notifying the Dubai Land Department of the purchaser's default and the Dubai Land Department will then notify the purchaser of the default and provide 30 days for it to be remedied;

b if the purchaser does not remedy the default within the permitted period, then the Dubai Land Department will issue an order in favour of the developer permitting it to undertake one of the following actions:
  - where the project is more than 80 per cent complete, then the developer can: (1) continue with the contract and claim the outstanding amount from the purchaser; (2) ask the Dubai Land Department to sell the off-plan property by public auction to recover the outstanding amount; or (3) terminate the off-plan property contract and retain up to 40 per cent of the purchase price;
  - where the project is 60–80 per cent complete, then the developer can terminate the off-plan property contract and retain up to 40 per cent of the purchase price;
  - where the project is less than 60 per cent complete, then the developer can terminate the off-plan property contract and retain up to 25 per cent of the purchase price;
  - where the project has not commenced construction, other than due to the developer's default, then the developer can terminate the off-plan property contract and retain up to 30 per cent of the purchase price;

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35 Article 60 of Federal Law No. 8 of 2017 On Value-Added Tax (VAT) and Article 57 of Federal Cabinet Decision No. 52 of 2017 On the Executive Regulations of the Federal Law No. 8 of 2017 On Value-Added Tax (VAT).

36 Article 4(1) of Federal Law No. 8 of 2017 On Value-Added Tax (VAT).

37 Article 71(2) of Federal Law No. 8 of 2017 On Value-Added Tax (VAT).

38 Abu Dhabi Executive Council Decision No. 14 of 2016 On Lease Contracts.

39 Dubai Law No. 19 of 2017 Amending Certain Provisions of Dubai Law No. 13 of 2008 Regulating the Interim Real Estate Register in the Emirate of Dubai.

c if the developer terminates the off-plan property contract, then the developer can retain the permitted proportion of the purchase price (as above) and must repay the balance of the amounts paid by the purchaser within one year of the contract being terminated or 60 days of the unit being sold to another purchaser, whichever is earlier; and

d the amended process does not exclude a purchaser's right to refer the matter to court or arbitration (as applicable) where there is a genuine dispute.

iv Dubai – acquisition of property by DIFC companies

A memorandum of understanding has been entered into between the Dubai Land Department and DIFC Authority permitting free zone companies incorporated in the DIFC to acquire property within Dubai's freehold areas (outside the DIFC) without requiring the approval of the Dubai Land Department.

v Dubai – regulation of surveying activities

A new law has been introduced to regulate land, water and seismic surveying in Dubai.[40] Under the law, the Dubai Municipality is authorised to regulate these activities and the production of cadastral plans and planning maps. It can issue permits to persons wishing to practise the surveying profession and impose fines for practising without a permit (up to 50,000 dirhams for the first offence).

vi Dubai – committee for building permits

A new law has been introduced to establish a committee that will develop regulations and procedures to improve the process for issuing building permits.[41]

VIII OUTLOOK AND CONCLUSIONS

In Abu Dhabi, the implementation of new property laws introduced in 2016 and procedures for the registration of property interests has continued. There is now a clearer regime for the regulation of property interests and widely utilised system for their registration. This is one of the most important success stories for Abu Dhabi real estate in recent times.

In Dubai, the local government has continued to focus on the refinement (where necessary) of the regulatory regime and protections afforded to investors and funders in order to promote sustainable growth in the property market. The most recent initiatives (mentioned in Section VII, above) illustrate the increasing scope and maturity of Dubai's regulatory regime.

The focus for the coming year will undoubtedly be the impact of the VAT law on real estate and transactions across the UAE. This is another ambitious project that will require time for implementation and for practices to become established. It is set against the backdrop of a challenging time for the property sector. While the cost of many transactions will increase, the introduction of VAT will provide a new source of revenue for the government, which, in turn, should support government investment in infrastructure and real estate projects to the benefit of the sector as a whole.

40 Dubai Law No. 6 of 2017 On the Regulation of Land Survey Work in the Emirate of Dubai.

41 Dubai Resolution No. 3 of 2017 Forming the Committee for Building Permit Procedures Development in the Emirate of Dubai.

Chapter 36

UNITED STATES

Meredith J Kane[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

The investor 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, as well as 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 will be discussed further in Section IV, below.

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 for the lessee's account. Ground leases are usually of at least 49 years' duration, and are 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.

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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 other 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 more than 3 per cent.

iii Choice of law

The laws of each state govern the legal frameworks of both the investment entities and the 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 continued its strong performance during 2017. Despite concerns that the boom market, which has been rising in value and transaction volume since 2011, may finally have topped out, both pricing and activity remained strong, despite a first-half lull. Without doubt, the key factor in the strength of the real estate market was the continued vigour of the underlying US economy overall. Job growth increased in multiple sectors, including technology, manufacturing, business services and warehousing, bringing with it a continued demand for office space, logistics space, and for multifamily residential space. Other additional key factors keeping prices and transaction activity strong in US real estate in 2017 included relatively modest increases in interest rates from the Federal Reserve that were easily priced into the market expectations, continued strong capital availability from pension funds and other institutional investors seeking strong returns, and the stability of the US markets that continue to provide a stable, safe haven for overseas investors' funds. The emerging consensus among real estate investors is that, unlike in past cycles, the real estate market trajectory may be in for a 'soft landing', rather than a hard downturn.[2]

The restructuring and refinancing of large and small loans and equity investments throughout all asset classes that has dominated the US real estate markets since 2008 was relatively smooth in 2017, with US$65.6 billion in debt maturities refinanced in the first half of 2017 through a combination of debt and equity. The relative ease of refinancing in 2016 and 2017 of the 'wall of maturities' of 10-year commercial mortgage backed security debt (CMBS) issued in 2006–2007 has led economists to coin the phrase 'The Wall of Debt that Didn't Crash'.[3] CMBS delinquencies continue to decline, to a low of 5.18 per cent in November 2017, as the legacy CMBS loans have been refinanced and the new CMBS loans exhibit significantly more conservative underwriting. Retail sector loans continue to raise the most concern. Of the US$29.3 billion in retail sector loans that matured during the 12-month period ending October 2017, 11.76 per cent were resolved with losses.[4]

The retail sector continues to transform as e-commerce puts increasing pressure on bricks-and-mortar retail. Both urban street-level retail and shopping centre retail have suffered major vacancies, owing to a large number of retailer bankruptcies and a reduction in store count by national retailers. In order to survive the challenge of online competitors, big-box stores, department stores and grocery retailers have increased their own emphasis on ecommerce initiatives and delivery systems. Retail store spaces and shopping centres have increasingly focused on reconfiguring their spaces into 'experience' centres focusing on food, entertainment and personal services, as well as other 'common space' uses.

The office sector also continues to transform, as start-up tech companies become more dominant space users, and older tech companies become more mature office users. The biggest phenomenon in office space leasing has been the rise of short-term, flexible office space offered on a weekly or monthly basis, with access to common services and common 'business interaction' spaces, through firms like WeWork and multiple competitors.

In terms of capital sources for real estate markets, CMBS issuances declined by 25 per cent from US$101 billion in 2015 to US$76 billion in 2016, marking the first decline in issuance since 2009. As of the first quarter of 2017, that decline further accelerated, to

2 Source: PriceWaterhouseCoopers, 'Emerging Trends in Real Estate 2018 Survey'.
3 Source: Economists Outlook., National Association of Realtors, June 2017.
4 Source: Trepp Talk, Retail Roundup, 1 November 2017.

a total of only US$15 billion, with an expected maximum of US$70 billion for the 2017 year. The decline is attributed to market volatility causing spreads to widen in highly-rated bonds, as well as to the effects of the 'risk-retention rule', which was put into effect during 2016 as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act.[5] The 'risk-retention rule' rule requires that issuers retain a minimum of 5 per cent of the risk in their CMBS issuances, either as a 'vertical slice' across all tranches, or a horizontal slice at the lowest tranche, or an 'L-shaped slice', combining vertical and horizontal interests. As CMBS issuances continue to shrink, banks are stepping up to provide the bulk of debt capital to the real estate markets, currently at approximately 40 per cent (nearly evenly split between domestic and foreign banks), and increasing potentially up to their historic levels of close to 60 per cent. Bank lending is followed by 'private or other' sources at 18 per cent, followed by life insurance companies, GSEs (for multifamily assets), and non-bank sources, including real estate funds and real estate investment trusts (REITs).[6]

Equity activity in real estate continued strong in 2017 as investors sought yield and equity was in demand to cover gaps in the capitalisation structure brought about by reduced loan to value ratios. Annualised private real estate fund returns in the three years ending June 2016 were 14.9 per cent, coming off of 26 straight quarters of growth. In addition to US$108 billion raised for private real estate funds in 2016, there was 'dry powder' – uncalled capital commitments to equity funds, evidencing availability of ready capital for investment – at US$227 billion in 2016, with the greatest availability for United States properties.[7] These funds include institutional equity commitments to real estate from pension funds, foundations and endowments, large capital sources, which in recent years have increased their exposure to real estate in order to increase yield. Institutional investors are still largely focused on 'core' properties with stable yields, but 'value-add' properties and secondary and tertiary markets, with the greatest potential for value increases, are included in institutional portfolios as strong competition for core properties has driven prices to extremely high levels.

Office leasing activity throughout New York City increased in 2017 to its highest level since its 10-year high previously reached in 2015, with over 26 million square feet of space leased in Manhattan. Office rents remained flat at about US$74 per square foot average asking rate in Manhattan. Major new office space at Hudson Yards as well as new and renovated spaces in East Midtown and Downtown Manhattan, Long Island City and Downtown Brooklyn are coming online after several years of development. Downtown Manhattan, with its relatively affordable office space, has become the new hub of the media and advertising industry in New York City. Affordable housing, particularly multi-family rental housing, remains a challenge that must be solved in order to sustain job growth in New York City and other high-cost urban areas.

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. Commercial real estate remains a relatively attractively priced asset, with the potential to generate substantial operating income and capital gains as markets continue to expand. For the first half of 2017,

5 Source: USAA Real Estate Company, 'What Happened to CMBS Issuance in 2016?', February 2017.

6 Source: Real Capital Analytics, Commercial Real Estate Market Trends, January 2016.

7 Source: Preqin Fund Manager Outlook 2017.

direct foreign investment in commercial real estate totalled US$19.8 billion, a slight decrease from 2016's pace, which totalled US$55.1 billion for the year. The major source of foreign capital remains Canadian pension funds, which accounted for 30 per cent of year-to-date foreign investor activity. Asian capital investment continues strong, with almost half of the offshore acquisitions in 2017 originating in Asian countries. Office space continues to be the asset of choice for foreign investors, with a focus on high-quality assets in primary office markets. China, Singapore and Japan, together with Canada and Germany, accounted for nearly 80 per cent of foreign investment in the US office space sector.[8] In a change from prior years, however, there was a marked diversification of asset classes and location choices for foreign investors. Multifamily assets were the second strongest commercial asset class after office, and were located across markets. Following a trend that domestic investors also initiated this year, given the high pricing of real estate assets in primary markets, a full 42 per cent of foreign investment was deployed to purchase assets in secondary and tertiary US markets.

Foreign investment in luxury US residential real estate remained strong in 2017. For the year ended the first quarter of 2017, foreign homebuyers invested US$153 billion into US residential real estate, up 49 per cent from the previous year. Chinese buyers were the most active, with purchases of US$31.7 billion during this period, with Canadian buyers in second place with US$19.1 billion. Foreign buyers now account for 10 per cent of existing home sales within the United States. Florida, California and Texas were the top destinations for foreign homebuyers.[9] Notable were the declines in all-cash purchases, as well as the decline in purchases of ultra-luxury condominiums in New York City. Only 10 per cent of foreign buyers paid more than US$1 million for their residential property. Among other things, the low price of oil throughout 2017, with its effects on the Russian and Middle Eastern economies, and the slowdown in the growth and capital export restrictions of the Chinese economy, has led to the slowdown of ultra-luxury US residential purchases in 2017. Additionally, a programme instituted by the federal government in cooperation with New York City, now requires disclosure of individual owners behind all-cash luxury apartment purchases, which is expected to lead to a continued decline in all-cash transactions, typical of ultra-wealthy foreign buyers.

i Foreign Investment in Real Property Tax Act

Foreign investment in US commercial real estate is generally done through a US-taxpaying entity, in order to avoid the 15 per cent withholding tax provisions of Internal Revenue Code Section 1445(a), implementing the provisions of IRC Section 897, the Foreign Investment in Real Property Tax Act (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 the state in which the real estate is located. The foreign investor is thus subject to the US income tax with respect to the ownership and operations of US real estate, including capital gains taxes on dispositions. At the end of 2015, long-sought amendments to FIRPTA were enacted into law, expanding exemptions from US taxes for foreign pension funds that invest

8 Source: JLL – the Investor Q3 2017.

9 Source: Inman Connect 7/2017, citing National Association of Realtors 2017 Profile of International Activity in US Residential Real Estate.

in US REITs or directly in real estate, thus putting foreign pension funds on similar tax footing to US-based pension funds. This change is intended to, and expected to, increase foreign pension fund investment in US real estate.

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. China is the main source of EB-5 investment dollars for US real estate transactions, exceeding 70 per cent of the EB-5 applications over the last three years. The EB-5 programme was recently extended through 19 January 2018, largely as a result of strong lobbying by the real estate industry. Its future after that point is uncertain.

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 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. The recently adopted US federal income tax overhaul further advantages the use of pass-through structures by providing for a 20 per cent deduction for all income earned through pass-through entities, before the individual tax rate is applied.

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. In order to enjoy a 'pass-through' tax treatment similar to LLCs and LPs, including the new 20 per cent deduction from taxable income, 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 are 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 (CERCLA) and Resource Conservation and Recovery Act (RCRA). 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 clean-up 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. Several insurance products are currently available to property owners to protect against unknown liabilities for prior pollution, and are becoming the norm in transactions for sophisticated buyers.

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 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 period of free rent 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 landlord's leasing of the building. The tenant will usually be required to give or share any sublease profits with 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 CAM, or 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 from 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

There is an ongoing rethinking of all aspects of lending practices in the CMBS market, in response to the default and workout experiences over the past four years. 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, which was first put into place in 2016. 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.[10] There has also been increasing focus on conflicts of interests between special servicers on CMBS portfolios and the bondholders whom they represent, 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 insolvency. In the case of a loan default, the borrower entities were discouraged from filing for bankruptcy through use of springing recourse guarantees and various SPE provisions, including 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;[11] 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.[12]

iii Enforcement of non-recourse carve-out guaranties

One of the most effective means for lenders to prevent a borrower for filing 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

10 Source: Fitch Ratings, Structured Finance, 'CMBS 1.0… 2.0… 3.0 …But Are We Progressing?', 4 January 2012.

11 *In re General Growth Properties, Inc., et al.* (Bankr. S.D.N.Y., Case No. 09-11977).

12 Ibid.

in an involuntary bankruptcy filing. In several decisions across the US in recent years, 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;[13]

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;[14]

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;[15] and

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.[16]

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.[17] The effect of these

13 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 Bank,* no. 09-01353 (SDNY 2009), finding that it is legitimate to carry out bankruptcy-remote structuring.

14 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-out just set terms of liability rather than setting measure of damages.

15 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 corporate guaranty of a debt of a subsidiary', and that such guaranties are a 'common commercial arrangement not subject to question'.

16 See *FDIC v. Prince George Corp*, 58 F.3d 1041 (4th Cir. 1995), finding that a carve-out guaranty did not prevent borrower from filing, but guarantor would merely forfeit its exemption from liability for any deficiency.

17 *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

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 (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: 'resilient' planning and building

Hurricane Sandy, which struck New York City and surrounding areas with lethal force in September 2012, has led New York City and much of the Northeast region to undertake a major reconsideration of land-use patterns, waterfront development, and building design and codes to enhance 'resiliency' in the face of long-term climate change. New York City had not earlier 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 2012 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 following 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 building code changes are being implemented. On the building level, resiliency improvements include installation of back-up generators and flood gates, raising the location of building equipment, and creating flood reservoirs in basements. On the City-wide level, resiliency reforms include redrawing flood zones, which will affect insurance costs and availability, retooling and waterproofing the electrical, transportation and communications grids, and rethinking waterfront zoning and development patterns.

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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).

VIII OUTLOOK AND CONCLUSIONS

The prospects for the US real estate market in 2018 remain strong; however, the expectation is for lower growth and greater stabilisation in values throughout markets across the United States. The core central business districts – New York City, Los Angeles, San Francisco, Houston, Seattle and Washington, DC – have seen more rapid increases in values and transaction volume than other areas of the country, and are expected to moderate, if not decline, in 2018, with growth continuing strong in secondary and tertiary markets where values are lower and value growth potential is stronger. Residential markets in these core areas, both multifamily rentals and condominiums, have strong transaction volumes and prices.

The top US 'markets to watch' in 2018 include Seattle WA, Austin TX, Salt Lake City UT, Raleigh/Durham NC and Dallas/Fort Worth TX, followed by Ft. Lauderdale FL, San Jose CA and Nashville TN.[18] Rents, asset values and transaction volume have increased strongly this year in these secondary and tertiary markets as the US economy has performed well overall and jobs have increased, including in the manufacturing and logistics sectors. The US housing market overall has stabilised tremendously compared with earlier years, as the overhang of foreclosed properties that depressed prices and sales volumes has eased through a lessened volume of new foreclosures and acquisitions by private equity funds of large quantities of single-family homes for rental occupancy. Although interest rates have begun a slow ascent from the historically low levels of recent years, the Federal Reserve is moving cautiously to avoid choking off needed growth, and the total volume of new loans and refinancings has increased with respect to previous years.

The new Federal Income Tax reform bill that was signed into law at the end of 2017 is expected to push more investment into commercial real estate through especially favourable tax treatment under the law, including the deduction on pass-through income, greater deductibility of interest expense and immediate expensing of qualified personal property. However, individual investments into homeownership may decline as the bill severely caps deductibility of home mortgage interest and real property taxes payable by an individual homeowner. Additionally, there is concern that states with high real estate and income taxes may lose high-income population to lower-tax states, with a concomitant effect on real estate prices, as the tax bill eliminated the deductibility of state and local taxes.

The overall outlook for 2018 is for continued equity investment in core office and multi-family assets across primary, secondary and tertiary markets by both domestic and foreign investors. The pace and value of growth and new real estate development, however, are directly dependent on the status of the overall US and global economies, including the flows of international capital, the relative returns available in other investment sectors, and the changes in the form of demand generated by the new tax law.

18 Source: Urban Land Institute, 2018 Real Estate Trends.

Appendix 1

ABOUT THE AUTHORS

DIEGO ARMERO

Uría Menéndez

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.

YASUO ASAMI

Nishimura & Asahi

Yasuo Asami is an associate with expertise in transactions involving the acquisition of, investment into, and financing of Japanese real estate assets. He also specialises in international trade and corporate acquisitions, as well as handling other general corporate matters between Japanese and Chinese companies. He was admitted to practise in Japan in 2008.

ALESSANDRO BALP

BonelliErede

Alessandro Balp is a partner in the Milan office of BonelliErede 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 BonelliErede 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.

JAN BERG

Bird & Bird

Jan Berg has 18 years' experience in providing advice in corporate relations and real estate transactions. Jan has worked for some of the major listed companies and funds in the industry for many years. Besides the pure transactional work, Jan regularly advises management teams and investors in relation to fund formation and establishment of various types of co-investment structures. Jan joined Bird & Bird in 2013, coming from a local leading corporate real estate practice.

JOHN BINGHAM

Bellwether Green

John Bingham is a founder of Bellwether Green, the only Scottish new start in 20 years to be ranked in *The Legal 500* and *Chambers* for real estate. John acts for a variety of property funds and listed companies. His team's practice covers all aspects of real estate work.

IAIN BLACK

Dentons

Iain is a partner in the corporate and commercial team based in the Dubai office of Dentons. He regularly advises on various corporate and commercial transactions including domestic and international mergers and acquisitions, private equity, joint ventures, restructurings, company establishments and equity capital markets. Iain has particular expertise in advising on corporate real estate transactions across the Middle East and Africa, including advising on the sales and acquisitions of hotel and leisure developments and advising landowners, investors and developers across a range of real estate projects.

NANAAMA BOTCHWAY

N. Dowuona & Company

NanaAma Botchway-Dowuona is the founder of N. Dowuona & Company. Her areas of focus are energy and infrastructure, corporate and commercial and property and construction. She is ranked as one of five elite lawyers in Ghana by *The Legal 500* and is recommended by *Chambers and Partners* and *IFLR1000*.

NanaAma has advised on numerous significant investments and divestments, and noteworthy projects in Ghana and other parts of Africa, such as:

- the US$200 million sale of Fan Milk International (a regional West African diary product company whose Ghanaian subsidiary is listed on the Ghana Stock Exchange) by the founding Danish private equity investors to the Abraaj Group;
- the development of the US$100 million mixed-use Movenpick Ambassador Hotel Project;
- the Volta Lake Transport Company's US$300 million Eastern Corridor Multi-Modal Transport Project; and
- proposed construction of a new LPG pipeline from the port of Tema to the Tema Oil Refinery.

NanaAma is a graduate of Princeton University's Woodrow Wilson School Undergraduate Program, New York University's Stern School of Business, where she received an MBA in finance and accounting and Columbia University School of Law, where she received a JD and was named a James Kent Scholar, the highest honor awarded in recognition of academic excellence.

NanaAma is also a member of the International Bar Association and the Ghana Bar Association.

DELFINA CALABRÓ

Estudio Beccar Varela

Delfina Calabró has been a lawyer at Estudio Beccar Varela since 2016, where she works in the real estate department. Her practice areas include real estate and mergers and acquisitions. She has broad expertise in corporate law.

Delfina received her law degree with honours from the Universidad Católica Argentina (2013). Delfina is a candidate for the Business Law Master Degree at the Universidad de San Andrés (which she is currently attending) in 2018.

JOE CARROLL

Dentons

Joe is a 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, Joe trained with a law firm in the City of London before qualifying into its real estate team. With many years' experience on the ground, working in house and in private practice, Joe 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.

JENNIFER CHIA

TSMP Law Corporation

Jennifer Chia is a partner in the transactional team of TSMP, focusing on financing and corporate real estate transactions. She heads the banking and finance practice and corporate real estate practice, and co-heads the private wealth and trust advisory desk. Her clients include banks, financial institutions, multinational corporates and high-net-worth individuals. Her work has been recognised in the *Chambers Asia-Pacific 2018 Guide* and *Asialaw Profiles* 2018.

ANTHONY J CORDATO

Cordato Partners Lawyers, Business, Property and Tourism Lawyers

Anthony Cordato has practised as a lawyer in the central business district of Sydney for many years.

Anthony now practises in his own firm, the boutique legal firm of Cordato Partners, which he founded in 1996. Anthony specialises in the fields of law he loves: business law, property (real estate) law; and tourism (travel law).

With his experienced team, Anthony looks after transactions and court work. For example: the purchase and sale of real estate and businesses; business advisory; travel-related contracts; finance for real estate and businesses; commercial leases; property development; property investment joint ventures; commercial disputes; town planning appeals; and real estate contract disputes.

Anthony is proud to have acted on more than 10,000 real estate transactions. His firm is cited as a party's solicitor in more than 65 reported decisions in the courts and tribunals of New South Wales and in the federal courts.

Anthony is the author of numerous publications, including articles in the *Australian Law Journal*. He has presented papers at seminars and conferences including the International Bar Association, the Law Society of New South Wales, the University of Technology Sydney and the University of New South Wales. He is an online contributor to *Lexology*, and many legal publications.

VALENTIN CREAȚA

Popovici Nițu Stoica & Asociații

Valentin Creața is co-head of the real estate practice of Popovici Nițu Stoica & Asociații, leading the real estate development group.

Valentin Creața holds a degree in law from the University of Bucharest and is member of the Bucharest Bar.

Throughout his career, spanning the past 18 years, Valentin Creața has provided key advice to high-profile real estate investors and developers in relation to the major acquisition, construction and operation projects, including the largest shopping centres and residential projects, office buildings, logistic centres and industrial parks.

Valentin Creața represents clients in a wide range of corporate governance cases and complex commercial matters, leading the real estate transactions team into the largest transactions in the market.

He is highly experienced in structuring and implementing high-ranked real estate portfolios or assisting extended greenfield and brownfield developments.

According to international legal directories, 'the real estate team at Popovici Nițu Stoica & Asociații operates to "the highest professional standards" and "is deeply committed to their needs"; Valentin Creața is recommended'.

YVES DELACROIX

Liedekerke Wolters Waelbroeck Kirkpatrick

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 the real estate programme at the Louvain School of Management).

He is described as an 'excellent lawyer' among Europe's leading individuals in *Who's Who Legal* (Real Estate, 2017).

Mr Delacroix joined Liedekerke Wolters Waelbroeck Kirkpatrick in 1990, where he became a partner in 2000 and where he now leads the real estate and regulatory practice. 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).

MAX VAN DRUNEN

DLA Piper Nederland NV

Max van Drunen is a legal director specialised in real estate law. He has advised on numerous real estate transactions, securities, funds, infrastructure and many other real estate-related topics. Mr Van Drunen has a special interest in projects in the field of sustainable energy and has advised on wind farms, solar parks and biomass power plants. His clients include listed and other large companies, pension funds, banks, grid operators and authorities. He often works in close cooperation with other expertise groups such as M&A, Finance and Regulation. Mr Van Drunen holds a PhD from Humboldt University Berlin 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.

ALEXANDRE EMOND

Liedekerke Wolters Waelbroeck Kirkpatrick

Alexandre Emond is partner in the real estate practice of Liedekerke. His work encompasses all aspects of real estate law, such as sale operations, sale and leaseback, lease and other occupancy rights. He also handles partnership agreements in the framework of large real estate development projects. He handles both real estate asset transactions (asset deals) and corporate real estate transactions (share deals). He also has specific expertise in real estate-related tax questions.

Alexandre graduated from the Université Catholique de Louvain (UCL 2002) and holds an advanced master's in tax law from the University of Brussels (ULB 2003). He also attended the executive real estate programme at the Solvay Brussels School of Economics and Management (ULB 2010). Alexandre joined Liedekerke Wolters Waelbroeck Kirkpatrick in 2003 and became a partner in 2013.

TIBOR FABIAN

Binder Grösswang Rechtsanwälte GmbH

Tibor Fabian has been a partner since 1996 and a real estate specialist at Binder Grösswang, and advises in all aspects of real estate law, including tenancy law and property development. He has advised various Middle East, German and Austrian investors on the sale, purchase and development of commercial, retail, residential and special portfolios (hotels, logistics). He also teaches as a lecturer at the law faculty of the University of Vienna.

PIERRE GEBAROWSKI

De Pardieu Brocas Maffei

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.

Admitted to the Paris Bar in 1997, he holds a master's degree from the ESCP (1992) and an advanced degree in business law from the University of Paris I Panthéon-Sorbonne (1997). He joined the firm as an associate in 2001, after working at Siméon & Associés (1997 to 1999) and Jeantet Associés (1999 to 2001). He was co-opted as a partner in 2005.

RIO ARMANDO GIRSANG

Ali Budiardjo, Nugroho, Reksodiputro

Mr Rio Armando Girsang joined ABNR as an associate in October 2013. He graduated *cum laude* in 2012 from the Faculty of Law of Padjadjaran University. As a student, he represented his university in various national mooting competitions and became head of the national moot division of the university's Moot Court Society. At ABNR, he has been involved in major transactions and projects, including in the development of the 180MW Asahan Hydroelectric Power Plant, the issuance of US$500 million global notes by PT Pelindo III (Persero), the issuance of US$40,000 million GMTN by the government of Republic of Indonesia, the development of the 2x660MW Tanjung Jati power plant, the development of the Jakarta-Bandung High-Speed Railway Project, the issuance of KAI's first corporate bond to finance the development of the Soekarno-Hatta International Airport Integrated Railway, as well as being involved in the ongoing financing of the LRT Jakarta Bogor Depok Bekasi Project with an investment value of approximately 29.9 trillion rupiahs. He has gained extensive experience and knowledge in financing transactions. He has also passed the required exams held by the Indonesian Capital Market Legal Consultant Association and is currently preparing to become a member of the Indonesian Capital Market Legal Consultant Association.

AYIK CANDRAWULAN GUNADI

Ali Budiardjo, Nugroho, Reksodiputro

Ayik Candrawulan Gunadi joined ABNR as in September 2001 and became a partner in October 2013. He graduated in 1997 from the Faculty of Law, Parahyangan Catholic University, majoring in economic and business law, and in 2000 completed his LLM programme at the Erasmus University Rotterdam, the Netherlands, majoring in business and trade law.

Before joining ABNR, he worked for a law firm and reputable insurance company in Indonesia. He also worked in the Netherlands, as foreign trainee with international legal and tax consultants in Rotterdam, and thereafter with a Dutch Bank in Amsterdam. He has extensive experience in matters involving corporate law, foreign investment, intellectual property and project finance, and has been actively involved in infrastructure projects in Indonesia. He was involved in the issuance of the PT KAI first corporate bond to finance the development of Soekarno-Hatta International Airport Integrated Railway, involving the ongoing financing of the LRT Jakarta Bogor Depok Bekasi Project with investment value of approximately 29.9 trillion rupiahs, as well as in the development of 2x660MW Tanjung Jati, a coal-fired steam power plant in Cirebon. He was also involved in the issuance of US$40 billion GMTN by the government of the Republic Indonesia. He is ranked by *IFLR1000* and *Asia Pacific Legal 500* in various practice areas.

ENRIQUE IGLESIAS ELIZONDO

Iglesias, Pozas y Páez

A partner at Iglesias, Pozas y Páez, Enrique Iglesias founded the firm in 1985; specialises in tax, asset planning, real estate projects, commercial contracts and corporate law matters.

Mr Iglesias graduated as an attorney from the College of Law of the Autonomous University of Nuevo León (Universidad Autónoma de Nuevo León) (1978) with post graduate studies in tax at the University of Monterrey (Universidad de Monterrey).

DUNJA JANDL

CMS Reich-Rohrwig Hainz

Dunja Jandl joined CMS as a partner in February 2017. She is a specialist in the field of real estate and construction, with 12 years of working experience, and has held senior positions in international law firms for the past four years. Dunja's focus lies on development of a commercial and hotel and leisure properties, covering all aspects of real estate acquisition, occupation, financing and construction matters, as well as real estate litigation. Her additional focuses are infrastructure and energy projects, where Dunja's expertise lies in regulatory (in the field of environment protection and energy law) and public procurement law.

She was admitted to the Slovenian Bar in 2010 and earned an LLM degree at LMU (Munich) in 2006. She is a certified mediator and speaks Slovenian, German and English.

TAMARA JELIĆ KAZIĆ

Odvjetničko društvo Bardek, Lisac, Mušec, Skoko d.o.o. in cooperation with CMS Reich-Rohrwig Hainz

Tamara advises clients from various industrial sectors regarding tax implications of international transactions, application of treaties on avoidance of double taxation, restructuring of companies and indirect taxation.

She is an attorney-at-law with the qualification for the UK certified accountant from the association of chartered certified accountants (ACCA). She has close to 15 years of international and domestic tax law advice experience. Prior to joining CMS, Tamara had worked in one of the Big Four companies for half a decade.

MEREDITH J KANE

Paul, Weiss, Rifkind, Wharton & Garrison LLP

Co-chair of the real estate department at Paul, Weiss, Rifkind, Wharton & Garrison LLP and a former 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 is currently Chair of the Board of Trustees of The Olana Partnership, and serves on the boards of the Lower Manhattan Cultural Council, the Urban Design Forum, the New York Foundation for Senior Citizens, the Association to Benefit Children, and the Avenue of the Americas Association (which she chaired from 1999 to 2007). Ms Kane is a member of the Real Estate Board of New York, WX-Women Executives in Real Estate, the New York Women's Forum, the ULI-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 serves as co-chair of the Practising Law Institute's 'CMBS for the Real Estate Lawyer' annual conference.

Ms Kane was honoured as 2017 Law360 MVP in Real Estate, the 2012 'Best in Real Estate' at the Euromoney Legal Media's inaugural Americas Women in Business 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. Commercial Observer has twice cited Ms. Kane, as part of its Power 100 list, as one of the 'Power Attorneys', the top real estate lawyers who are 'the legal world's most powerful, most connected and most exciting players'. In 2015, Commercial Observer profiled Ms Kane individually as one of New York's most influential real estate attorneys. 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.

SERGEY KOLOBOV

Herbert Smith Freehills CIS LLP

Sergey Kolobov is a Russian-qualified lawyer specialising in general corporate law, including M&A and joint ventures. He also has experience of work on real estate projects, financing of commercial construction projects, acquisitions and disposals of commercial properties.

He graduated from the international law department of the Moscow State Institute of International Relations (MGIMO). He joined the firm in 2011.

KATERINA KRAEVA

Wolf Theiss

Katerina Kraeva is an experienced lawyer with almost 20 years' practice in Bulgaria. Prior to joining Wolf Theiss, she has taken senior positions as in-house lawyer in Bulgarian banks and in international law firms. Key to her expertise is her focus on niche spheres in banking and finance, corporate, M&A and real estate fields where there is scarce local knowledge and practice. Having worked as a senior lawyer in international law firms since their entry into Bulgaria, she has had access to innovative legal areas, and has an extensive track-record as a finance lawyer advising both lenders and borrowers in acquisition finance, real estate financing, project financing and restructuring.

IVAN KRANJEC

CMS Reich-Rohrwig Hainz

Ivan Kranjec joined CMS in 2014 after more than seven years' experience as a tax advisor in local and Big Four tax consulting companies. His experience also extends to a legal advisory role in private legal practice and the Trademark Office.

After graduating at the Faculty of Law at the University in Ljubljana in 2007, he also obtained a master's degree in tax law at the University of Maribor and successfully passed the Slovene Bar exam.

Ivan is a tax law specialist, operating primarily in the field of transfer pricing and value added tax, where he cooperates with domestic and foreign client from different industry sectors (financial, retail, pharma, automotive industry, etc.), but he also consults on other taxes and legal topics. Ivan particularly gained his experience through direct consulting for domestic and foreign clients, as well as tax planning, tax structuring and due diligence projects.

YI-LI KUO

Lee and Li, Attorneys-at-Law

Yi-Li Kuo, a senior attorney at Lee and Li, Attorneys-at-Law, is licensed to practise law in Taiwan and has been admitted to the New York Bar. Her expertise lies in real estate and construction, mergers and acquisitions, corporate regulatory compliance and electronic payment services. Ms Kuo regularly assists domestic and international clients with complex real estate deals (including the purchase and sale of real property, investments in real property and hotel management) and M&A transactions. She has also represented foreign clients in disputes arising from large-scale constructions.

DENNIS LI

Slaughter and May

Dennis Li is the head of property at Slaughter and May, Hong Kong. He has over 15 years' experience in Hong Kong real estate law and practice and has acted for major developers, financiers, banks, funds and private investors on a broad range of local and offshore real estate projects, including acquisitions/disposals, financing, strata sales and leases of multi-user complexes.

Dennis was previously the head of legal and the group secretary of a Hong Kong listed property developer, where he specialised in the sale/acquisition strategies of the group's land bank.

YVONNE LIAN

TSMP Law Corporation

Yvonne Lian is an associate in the transactional team of TSMP and assists in a wide array of transactional work.

ERIC LIU

Dentons

Eric Liu is a partner 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 cross-border M&A and joint ventures. He is a key member of the Dentons construction and real estate practice in the Greater China region and has advised owners, developers and managers with respect to a variety of high-end hotel, shopping mall and serviced residential condominium projects in China.

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 having a particular focus on hotel and resort law. He also has experience in drafting and negotiating all property-related documentation.

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.

MARIJA MAROŠAN

Petrikić & Partneri AOD in cooperation with CMS Reich-Rohrwig Hainz

Marija Marošan joined CMS Belgrade in March 2013 from a reputable regional law office. She obtained her master's degree in land management from the Royal Institute of Technology in Stockholm. Marija Marošan mainly focuses on real estate law and can draw on several years of experience in advising international companies in Serbia and Montenegro on real estate law matters (especially the drafting of construction agreements, FIDIC contracts, agreements on the sale and purchase of real estate, lease agreements, registration of property rights, expropriation, restitution, etc.).

LEEN VAN DER MAREL

DLA Piper Nederland NV

Leen van der Marel is a legal director in the real estate practice. His practice involves all aspects of the real estate industry with particular emphasis on representation of (institutional) investors and project developers in (complex) real estate acquisitions and developments. Mr Van der Marel also regularly teaches courses on real estate acquisitions, project development and tenancy law. His clients include some of the most recognised investors and developers, including companies active in the hospitality and logistics sector.

MIHAJLO MATKOVIĆ

CMS Reich-Rohrwig Hainz

Mihajlo Matković joined the CMS Podgorica team in June 2015. He graduated from the faculty of law at the University of Belgrade in 2011 and passed the Bar exam in 2014. Prior to joining the firm, he spent almost five years working at two renowned Serbian law offices. His legal work primarily focuses on banking and finance, dispute resolution and real estate matters. In his previous engagements, Mihajlo Matković has represented clients before courts in Serbia in a variety of civil disputes, bankruptcy and enforcement proceedings. Furthermore, Mihajlo Matković has been actively involved in some of the most complex and significant transactions in Serbia, predominantly dealing with project financing, banking and finance and real estate law-related matters.

TORBEN MAURITZEN

DLA Piper

Torben Mauritzen specialises in real property transactions and financing. He has extensive experience in representing foreign real property investors in Denmark, including in the optimal structuring and completion of investments in Danish real property and subsequent development of the acquired properties. He has vast experience in working with the Danish public sector and its political processes regarding, for example, local development plans and amendments to municipal plans, building and other permits and changed use of property.

ATANAS MIHAYLOV

Wolf Theiss

Atanas Mihaylov is a senior associate in Wolf Theiss's Sofia office, with substantial experience in the development of real estate projects. Atanas' experience includes advising real estate developers on property rights acquisition, land use and permitting, technical infrastructure issues, construction, environmental regulations, commercial leasing and asset management, financing and sale documentation, and tax planning throughout the investment life cycle of the real estate project (acquisition, exploitation period and exit). He has also frequently been involved in addressing real estate aspects of non-real estate transactions (e.g., mergers and acquisitions, corporate and financing transactions) and energy projects.

WILLIAM MO

Dentons

William Mo is a senior partner in the Shanghai office of Dentons. His practice encompasses a broad range of transactions, with an emphasis on the development, acquisition, financing and tax saving of many commercial, residential and industrial real estate projects.

Having practised in the greater China region for more than a decade, Mr Mo has advised many industry parks, office, retail shops or hotels on its post leasing and commercial operation. He also has practical experience and long-term study of real estate companies' IPOs and bond issuing, disposition of non-performing loans, outbound investment as well as REITS and CMBS. He is familiar with different kinds of bilingual construction contracts, and has participated in the construction of several large-scale real estate projects and the settlements of foreign construction disputes.

JOHN NEVIN

Slaughter and May

John Nevin is a partner in the real estate group at Slaughter and May. He has considerable experience in a wide range of real estate work. He has acted extensively on acquisitions and disposals of all types of property interests, on significant development projects and on major lettings. His clients include developers, livery companies, retailers, hotel and public house companies and banks. He is listed as a leading individual in the real estate section of *Chambers UK 2018* and is also listed in *Who's Who Legal: Real Estate 2017*.

PEDRO NICHOLSON

Estudio Beccar Varela

Pedro Nicholson is head of the real estate and hospitality department of Estudio Beccar Varela. Pedro has lectured in conferences in Argentina and abroad, and has been recognised as 'Real Estate Lawyer of the Year' by *Best Lawyers* in 2017; 'Leading Real Estate Lawyer' by *Chambers & Partners* for the 2008–2017 and by *Practical Law Company* for 2007–2017.

He is co-chair of the real estate committee of the American Chamber of Commerce in Buenos Aires, member of the Executive Committee at the Housing Entrepreneurs Association, officer of the Real Estate Committee at the International Bar Association, officer of the Latin American Law Committee of the International Council of Shopping Centres and former president of the Alumni Association of the Real Estate Business Centre of the Universidad de San Andrés. Pedro obtained a post graduate degree in Real Estate Transactions from the Universidad de San Andrés (2006), a post graduate degree in Hotel Investments from the Universidad de San Andrés (2009), an LLM from the University of Illinois at Urbana-Champaign (1993) and worked as a foreign associate at Hogan & Hartson (currently Hogan Lovells), Washington, DC (1995).

INDIR OSMIĆ

CMS Reich-Rohrwig Hainz

Indir is an attorney-at-law in Bosnia and Herzegovina admitted to the FBiH Bar. He holds a graduate lawyer degree from University of Sarajevo. He was a Fulbright scholar at the American University – Washington College of Law in 2012/2013 during his master studies. His main fields of expertise are corporate law, finance law, real estate law, compliance and tax law. Indir's work also includes corporate finance work, such as coordinating M&A deals with particular focus on finance structuring and regulatory. He has expanded his experience by working as a country team leader in complex regional cross-border transaction projects. He is fluent in Bosnian, Croatian, Serbian and English and possesses a good knowledge of Spanish.

DAVID PÁEZ GONZALEZ

Iglesias, Pozas y Páez

A partner at Iglesias, Pozas y Páez, David Páez specialises in foreign investment, general corporate matters, financial transactions and operations, mergers and acquisitions, joint ventures and real estate projects.

Mr Páez, obtained his law degree from the Monterrey Institute of Technology and Higher Education (Instituto Tecnológico y de Estudios Superiores de Monterrey) (1997), and obtained his Master of Laws degree (LLM) from the University of Illinois College of Law (2002).

RODRIGO PERUYERO

Uría Menéndez

Rodrigo Peruyero is a senior associate in the Madrid 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.

ĐORĐE POPOVIĆ

Petrikić & Partneri AOD in cooperation with CMS Reich-Rohrwig Hainz

Đorđe Popović is a partner at CMS Belgrade with more than 10 years of relevant experience. He joined CMS Belgrade in 2011 after having worked with a reputable regional law firm for five years. He obtained his master's degree from the University of Bonn and his securities law postgraduate specialist degree from the University of Belgrade. Đorđe Popović is an experienced corporate attorney who has advised on a number of prominent transactions in the central and eastern Europe region, including mergers, acquisitions, takeovers (friendly and hostile), buyouts, privatisations and joint ventures. His particular focus in the past couple of years has been on energy, project finance and real estate matters, and he has extensive experience in providing legal support to major international clients on Serbian, Montenegrin and Bosnian law in these areas. His additional areas of specialisation include telecoms, regulatory matters and PPPs. In parallel with his practical work, Đorđe Popović has dedicated considerable energy to legal research and has published relevant papers in the United Kingdom, Germany, Greece, and Bosnia and Herzegovina.

JOSÉ G POZAS DE LA VEGA

Iglesias, Pozas y Páez

A partner at Iglesias, Pozas y Páez, José Pozas specialises in real estate projects, mergers and acquisitions, foreign investment, general corporate matters and commercial contracts.

Mr Pozas obtained his law degree from the Free Faculty of Law of Monterrey (Facultad Libre de Derecho de Monterrey) (1992), and obtained his Master of Comparative Jurisprudence degree (MCJ) from the New York University School of Law, New York, NY (1995).

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 Panthéon-Assas (2000). He was co-opted as a partner in 2008.

TAMARA SAMARDŽIJA

CMS Reich-Rohrwig Hainz

Tamara Samardžija started working as an associate at CMS in November 2011, after graduating from the Faculty of Law, University of Belgrade. During and after her studies, she completed several courses in the fields of corporate law, international law and litigation, and attended various conferences and traineeships. In 2013, she completed a secondment with a very reputable client in Montenegro whose business activities are mainly focused on real estate development industry. She passed the Bar exam in 2015 and became a member of the Belgrade Bar Association. Tamara successfully advised clients in numerous cross-border M&A transactions, financial and corporate restructuring projects. She provides legal support to some of the most prominent international companies in establishing their business operations in Serbia and Montenegro, in conducting their everyday business operations, with respect to corporate, commercial, real estate, regulatory and employment related matters.

JANUSZ SIEKAŃSKI

Sołtysiński Kawecki & Szlęzak

Janusz Siekański heads the firm's real estate practice. He is primarily engaged in conducting complex cases concerning real property-related litigation, as well as arbitration, administrative and administrative judicial disputes. These include disputes among co-owners, heirs and interest holders, disputes on ownership, including usucaption and reprivatisation, and compensation cases.

ANA-MARIJA SKOKO

Odvjetničko društvo Bardek, Lisac, Mušec, Skoko d.o.o. in cooperation with CMS Reich-Rohrwig Hainz

Ana-Marija Skoko is the head of the real estate and construction department. Since joining the team in 2006, she has advised mostly large international developers with reference to their investment in Croatian real estate, which includes due diligence and advising with regard to sale and purchase of real estate, spatial planning and construction.

During her 10 years of legal practice, Ana-Marija Skoko has specialised in project development – and particularly in the development of shopping centres – which includes providing continuous legal advice throughout the life cycle of a project; drafting and negotiation of sale and purchase agreements (for the developer as the purchaser), project development agreements and construction agreements (FIDIC); legal support during the issuance of relevant permits; drafting and negotiations of lease agreements for local and international landlords; and ultimately drafting and negotiation of sale and purchase agreements (for the developer as the vendor). In this field, Ana-Marija Skoko works closely with the corporate department, allowing for the provision of a more integrated service to clients.

YI-JIUN SU

Lee and Li, Attorneys-at-Law

Yi-Jiun Su, a partner at Lee and Li, Attorneys-at-Law, is licensed 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. Apart from extensive experience in handling conveyancing, international engineering and construction works for a wide range of clients from different jurisdictions, she has also represented investors, developers, equity funds, retailers and wholesalers, hotel and resort operators, contractors and consortia in matters involving conveyancing, leasebacks, big-box and retail store openings, 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.

NICOLA DE SYLVA

Al Tamimi & Company

Nicola de Sylva is a senior associate in Al Tamimi & Company's Qatar office, having previously worked in the UK, Australia and New Zealand. She has advised on a wide range of commercial matters, with particular expertise in commercial property law and transactions, including acquisitions, divestments, project developments (including hotel and shopping centre development), design build and lease agreements and commercial leasing, and has acted on many high-profile and complex transactions in the property market.

ANA TERZIĆ

CMS Reich-Rohrwig Hainz

Ana Terzić joined CMS Reich-Rohrwig Hainz as an associate in March 2014. She completed her legal studies at the University of Sarajevo in 2011 and received a Master of Laws degree in German and European law and legal practice from the Humboldt University of Berlin in 2012. She has also received legal education at Heidelberg University and the University of Virginia School of Law. Prior to joining CMS, she was a trainee lawyer in a notary office in Sarajevo and at the Representation of the European Commission in Germany. She works and has experience in corporate law, mergers and acquisitions and real estate law. Ana Terzić is fluent in Bosnian, Croatian, Serbian, German and English, and has advanced knowledge of French.

VESNA TIŠLER

CMS Reich-Rohrwig Hainz

Vesna Tišler joined CMS Reich-Rohrwig Hainz in 2015 after she had successfully passed the Slovenian Bar exam. In October 2017, she was admitted to the Slovenian Bar. She graduated from the University of Ljubljana in 2010 and then continued her education at the Europa-Institute of the Saarland University in Germany where she finished the LLM programme in European law. After completing her studies in 2011, she gained experience at the European Commission, European Parliament and an international law firm in Brussels. In January 2013 she started working as an associate in an international law firm in Ljubljana where she stayed until the Bar exam. As a senior associate at CMS Reich-Rohrwig Hainz, she works mainly in the fields of real estate, banking and finance and public procurement law. She regularly advises international and local companies on real estate law matters, especially focusing on lease and security agreements, and performing legal due diligences concerning investments into real estate.

CARL-MAGNUS UGGLA

Bird & Bird

Carl-Magnus Uggla has 18 years of experience as an adviser on corporate tax. He has primarily focused on real estate transactions and structuring, but has also continuously worked with tax litigation and day-to-day tax advice. *Chambers Europe* states that Carl-Magnus 'is good at understanding complicated structures, seeing the problems and finding ways to handle them with the counterparty' (2017), that he 'can definitely be recommended' (2016) and that he is an 'increasingly prominent Swedish tax lawyer, who advises on complex restructuring and transactional mandates for Swedish and international clients' (2015). *The Legal 500* recommends him (2017) and notes that he is 'highly experienced' (2015). He has been featured in *ITR/World Tax* every year since 2013, when they stated that he has 'experience in corporate taxation, focusing on M&A, restructurings, and international/EU taxation' and that 'he is also an experienced tax litigator, and of course is one of Sweden's leading real estate experts'. He has also been recommended by *Who's Who Legal: Corporate Tax* (2010, 2011).

MARKUS UITZ

Binder Grösswang Rechtsanwälte GmbH

Markus Uitz is a partner in the real estate team and concentrates on real estate transactions. He is frequently involved in national and international acquisitions and disposals of Austrian assets such as, recently, the 'Hotel Imperial', project 'space2move' and the historical landmark Postal Savings Bank Building. He is also involved in the setting up of joint ventures between investors, for example, between Corestate and Soravia on the development of four high-rises in Vienna, with one of them becoming the highest tower block in the German-speaking countries.

ANDREAS F VÖGELI

Niederer Kraft & Frey

Andreas F Vögeli heads the real estate practice at NKF that deals with a variety of highly complex real estate transactions. He specialises in large and complex domestic real estate transactions, with a particular focus on enterprises that are involved in project development, hotel or leisure projects. His real estate experience also includes a profound knowledge of hotel and leisure projects, special rental contracts, Lex Koller and environmental law issues.

Mr Vögeli is expert at the University of Zurich at the MAS Real Estate and regularly holds seminars in real estate matters. He is a council member of the Real Estate Management programme of the Institute of Financial Services Zug IFZ, Lucerne University of Applied Sciences and Arts.

Mr Vögeli is highly reputed among clients throughout Switzerland and abroad. He is distinguished as leading real estate lawyer by *Chambers Europe* and *The Legal 500* and won the ILO Client Choice Award 2017 and 2018 in the category Real Estate for Switzerland.

NIKOS A VOUHIOUNIS

Bernitsas Law

Nikos is an associate at the firm, which he joined in 1998. His expertise lies in the development of high-value touristic, primary and secondary residential and commercial projects, in the context of which he has acquired substantial knowledge on town planning, forestry and archaeological issues.

He has successfully advised institutional investors, private equity funds and touristic and commercial operators entering the Greek market on major real estate projects, including the development, acquisition and commercialisation of residential complexes and touristic facilities, commercial malls and office space buildings.

Nikos has extensive knowledge of real estate privatisation tender procedures carried out by the Hellenic Republic from the point of view of both the Greek state and participants in tenders. In this context, he has advised on real estate and town planning issues, participated in acquisition and disposal negotiations, drafted transaction documentation and advised on the commercialisation of land development projects.

He is an expert in drafting commercial lease, long-term lease, sale and lease-back and co-operation agreements for hotel and cinema operators, retailers and other businesses. Nikos' commercial law practice is focused on advising clients on their entry into commercial contracts and joint ventures and issues arising in the course of their business operations. He has also acted in numerous mergers and acquisitions.

RADOSŁAW WASZKIEWICZ

Sołtysiński Kawecki & Szlęzak

Radosław specialises in commercial real estate, real estate transactions and development. He advises Polish and international institutional clients, developers, investors, retail chains, logistic operators and occupiers. Radosław has also been involved in a number of large, industrial greenfield projects in special economic zones.

KEISUKE YONAMINE

Nishimura & Asahi

Keisuke Yonamine is an associate who mainly focuses on transactions involving the acquisition of, investment into, and financing of Japanese real estate assets. He was admitted to practise in Japan in 2011.

CHRISTINA C ZAKOPOULOU

Bernitsas Law

Christina is an associate at the firm and joined in 2000. She specialises in retail and commercial real estate and significant land development projects.

Christina's extensive real estate experience encompasses advice on the acquisition and sale of real estate including commercial, residential, hotel and leisure developments and construction contracts. In this context she has also advised on town planning and forestry issues. She acts for investors, private equity funds, developers and managers with respect to a variety of high-end hotel projects and is active in teams working with real estate consultants, architects, engineers and other professionals. She handles both real estate asset transactions (asset deals) and corporate real estate transactions (share deals).

Christina also has specific expertise in real estate privatisation tenders and the development of real estate assets by the Hellenic Republic Asset Development Fund (HRADF) since it was established in 2011.

Christina also has experience of acting in public and private mergers and acquisitions, including due diligence and share capital increases. She undertakes company structuring and formation and ongoing corporate governance and advises on regulatory compliance. She also structures, drafts and negotiates commercial agency, commercial lease, share sale and purchase, share contribution and other commercial agreements.

OLIVER ZBINDEN

Niederer Kraft & Frey

Oliver Zbinden regularly advises and represents domestic and foreign investors, financial institutions, companies and private clients in all aspects of real estate law, particularly real estate transactions, tenancy law, private construction law, public construction and zoning law, environmental law and Lex Koller issues.

Appendix 2

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