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International Real Estate News

Newsletter of the Real Estate Section of the
International Bar Association Legal Practice Division

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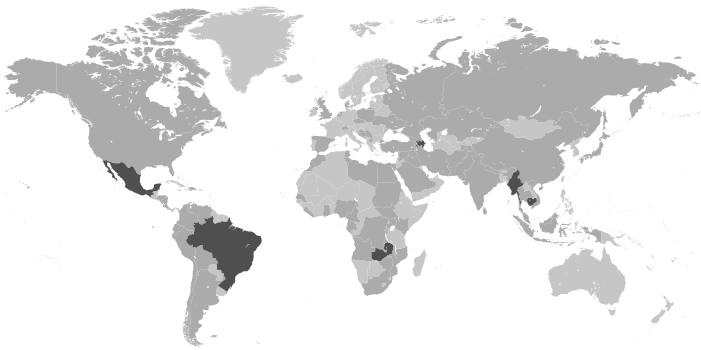

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From the Chair

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It is a great pleasure to present you with our second newsletter of 2016 with an impressive collection of articles. It is an even greater pleasure for me to report the growth and developments of our committee.

Our **8th Real Estate Investments Conference**, which took place in Copenhagen on 13–15 April 2016, was so far the most successful of our committee's conferences. Over 160 participants from 38 countries attended true fireworks of informative and thought-provoking sessions as well as entertaining social events in beautiful Copenhagen and enjoyed networking at its best among top real estate lawyers. That success was thanks to our Conference Chair, Jakob Shou Midtgaard of Plesner, who set up this event with the support of leading Danish law firms and a dedicated team of Real Estate Committee officers.

The moderators and speakers were leading practitioners and industry representatives, economists, real estate consultants and corporate finance advisers from around the world who led the engaged audience and discussed hot topics, such as upcoming mega trends, developments in M&A real estate, forward commitments, warranty claims and insurance, real estate and capital markets, super brands, hotels, and retail and shopping centres – trends and structure of leases and concession agreements. The session entitled 'Real Estate 2030 – Visionary Thinking' gave an insight into what the real estate industry could look like 15 years from now. Roundtable discussions permitted specialised debates on hot topics. The conference concluded with an open officers' meeting.

For the forthcoming IBA Annual Conference in September 2016, in Washington, DC, we are planning a number of exciting events:

- At **1430–1730, Monday 19 September,** a session on **Complex Real Estate Transactions**, chaired by our officers Peter Kunz, Bernat Mullerat and Izabella Zielinska, will discuss solutions to legal challenges facing real estate lawyers in today's complex world.
- At **1430–1700, Tuesday 20 September**, our committee will be cosponsoring a session on **Understanding the environmental**


Nikolaus Pitkowitz

Ramifications of Real Estate.

- At **2030, Tuesday evening**, the traditional **Real Estate Section dinner**, the networking event of our committee, will take place at the popular Carmine's restaurant.
- **At 1430–1700, Wednesday 21 September**, our traditional **Real estate property tour** will guide you through developments in Washington, DC.
- At **1045–1230, Thursday 22 September**, we will hold a section on **Innovative billing models: what to learn from real estate transaction lawyers?** In this session, supported by the Law Firm Management Committee and the Corporate Counsel Forum, managing partners and in-house counsel will debate how to provide added value to the client through billing and even make money by saving clients money.
- At **1200–1300, Thursday 22 September**, we will convene an **open officers' meeting**, where the committee officers will discuss future projects. One particular topic is succession planning. This is a special opportunity for those who want to be involved in the committee.

You can find more information on our sessions on page 8 of this newsletter. We look forward to seeing many of you at these exciting sessions.

Please mark your diaries for two events in 2017 and 2018:

- On 30–31 March 2017, we will host our 9th Real Estate Investment Conference in **Rio de Janeiro**
- On 6–8 2018, our 10th Real Estate Investment Conference is scheduled to take place in **Zurich**

I take this opportunity to thank all the engaged officers of our committee for their hard work for our committee, especially for the cooperation that made our Copenhagen conference such a success; and in preparing the Washington, DC conference and the two forthcoming annual conferences in Rio de Janeiro and Zurich.

A special thanks to Roland M Müller for his efforts in getting two newsletters out this year, demonstrating the wealth of activities of our Real Estate Committee.

Images: Speakers and delegates at the 8th Real Estate Investments Conference.

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This is the third, and last, newsletter published during our 2015–2016 term as newsletter editors of the IBA Real Estate Section. It is being distributed both online and in a printed format. You should receive this in time for the IBA Annual Conference in Washington, DC.

The next newsletter will be published in the first quarter of 2017 (prior to the 9th Annual Real Estate Investment Conference, which will take place in Rio de Janeiro from 29–31 March 2017). We strongly encourage each of you to not only attend these two great events, but also to grab the opportunity to place an article from your country in the forthcoming editions of the newsletter.

We thank you for all the great articles we have received over the past few months, as well as the support by the IBA team, in particular Ed Green. This made it possible to publish the newsletter on a regular basis and well in advance of our conferences.

We look forward to meeting many of you in Washington, DC or Rio de Janeiro.

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IBA2016 18–23 SEPTEMBER WASHINGTON, DC

ANNUAL CONFERENCE OF THE INTERNATIONAL BAR ASSOCIATION

Real Estate Committee sessions

Monday 1430 – 1730

Complex real estate transactions

Presented by the Real Estate Committee

Simple sale of real estate? Not at all! Nowadays, more than ever during the ordinary course of real estate deals, we face complicated/complex structures, from the obligations imposed by the institutions financing the acquisition and problems with releasing existing securities, forward agreements, negotiations with various parties to secure that the purchaser will acquire all the properties almost at the same time, to big acquisitions of entire portfolios in various jurisdictions governed by one master agreement and subject to separate purchase agreements in each jurisdiction.

And, let's not forget bond financing, tax increment financing, yield-maintenance break-up fees, and defeasance issues and requirements, among the many issues and choices that can confront and confound the parties to the transaction, if not their counsel. Throw in cross-border issues and the legal and cultural differences inherent when transactions cross borders, and you have a transaction that presents both challenge and opportunity to all involved. The role of counsel in overseeing and running the transaction and orchestrating the activities of the many players involved in such complex real estate transactions has never been more critical. This session is not only targeted at real estate lawyers, but also at other specialists, whose practice touches real estate issues, to get the most from this discussion.

Tuesday 1430 – 1730

Understanding the environmental ramifications of real estate

Presented by the Environment, Health and Safety Law Committee and the Real Estate Section

Environmental issues are increasingly at the forefront of any real estate transaction, including due diligence for contamination, environmental assessment and review requirements for development projects, the need to mitigate environmental issues for permitting requirements, and working with government agencies when public or sensitive land will be impacted. This panel will explain how to navigate complex environmental issues that are critical to successful real estate transactions and development projects.

Wednesday 1400 – 1730

Real estate property tour

Presented by the Real Estate Committee

In addition to the interesting sessions, the Real Estate Committee will organise our special real estate property tour. The idea of the tour is to provide participants with an insider's look at landmark developments through a tour of many of Washington, DC's key districts.

Thursday 1200 – 1300

Real Estate Committee open committee business meeting

Presented by the Real Estate Committee

An open meeting of the Real Estate Committee will be held to discuss matters of interest and future activities.

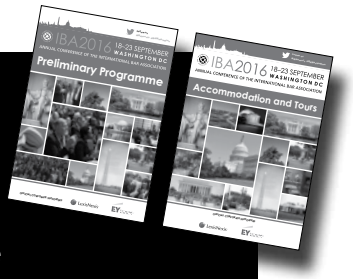
Thursday 1045 – 1200

Innovative billing models: what to learn from real estate transactional lawyers

Presented by the Real Estate Committee, the Corporate Counsel Forum and the Law Firm Management Committee

Is time-based billing coming to an end? How does digitalisation, artificial intelligence and commoditisation change the billing methods of the industry? Time-based billing has been the standard of the industry from the 1970s and now digitalisation is inevitably changing the business. We already have interesting and innovative solutions for a new way of billing. How do they work? Is it possible to give added value to the client through billing? Is it possible to make money by saving clients money?

To find out more about the conference venue, sessions and social programme, and to register, visit **www.ibanet.org/Conferences/Washington2016.aspx**. Further information on accommodation, tours and excursions during the conference week can also be found at the above address.



ARTICLES

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Challenging retail: multi-channel concepts and the question of turnover

Trade is change and subsists on innovations. In our digitalised world, this even applies to the retail real estate industry and its players. Smartphone and the almost unlimited opportunities (to shop) on the internet represent cross-generational basic needs, which want to be satisfied. This, for example, becomes obvious by the expansion plans and continuously increasing turnover figures of Amazon, Zalando and others. Nowadays, customers expect an interconnected shopping experience that combines classic trade locations with digital distribution types.

These expectations of the (digital) customer as well as the further development of multi-channel concepts challenge developers, planners and property owners as well as operators and tenants of retail properties. To master these challenges successfully, a high level of innovation ability is required. The merchant's innovative power, however, comes across (supposed) obstacles often in the case of the legal framework.

Contracts, especially lease agreements, which, in general, are concluded for a longer period in the lifecycle of a commercial real estate property, can anticipate the change of distribution types and changing consumer behaviour in a digitalised world only to a limited extent. Therefore, a flexible framework is often only achievable to a certain extent. For this reason, the legal framework, mechanisms and principles established on the market have to be reconsidered and scrutinised regularly – as far as possible in accordance with legal regulations – and have to be reviewed with regard to their innovation ability and flexibility.

Long-term lease agreements and startups

In commercial lease agreements (for retail properties), the definition of the contractually allowed use of the lease object is of high priority. Traditional definitions of the lease purpose regularly provide a rather one-dimensional use as a shop or shop area. However, the allowed use of the lease object by the tenant is thereby limited. Deviations from the contractually allowed and defined use are – at least regularly – only permissible with the prior written approval of the landlord.

This definition might even be combined contractually with defined prohibitions pursuant to which the area in the lease object may not exceed a certain size for the contractually agreed purpose. Regularly, such limitations are combined with restrictions on assortments, quality and the like to comply with public law limitations set forth, inter alia, in the building permission.

Even if such restrictions are comprehensible from an operative-strategic or public building law point of view of the property owner or operator and, in some cases, are even compelling, they limit the tenant's flexibility and therewith its opportunity to react on new developments and possibilities. However, this isn't helpful for tenants with innovative distribution methods and multi-channel concepts. Particularly in the light of long-term lease agreements of at least five years, such restrictions rather obstruct or even scare off interesting startups, which need some kind of flexibility.

It is evident that retail spaces are nowadays rather a stationary addition to the existing online distribution system and part of so-called click-and-collect concepts. Following this, the emphasis of modern retail space

usage is less associated with a traditional shop area, but as – depending on the specific concept – a showroom or event location, complemented by components of warehouse and logistics areas.

Classic turnover definitions are stretched to their limits

And yet the stationary retail space is the visual and haptic addition to online distribution and combines it with the advantages of a present warehouse and logistics area. This gives the tenant the opportunity to have numerous and various goods available on site and offer to its (online shopping) clients the possibility to return and/or exchange the goods in the stationary shop. Thereby, the clients have the opportunity to collect or exchange the ordered goods in the nearest business unit. Thus, high return rates and therewith return costs can be avoided and the customer frequency in the stationary unit and in the centre overall can be increased.

Classic (centre) lease agreements regularly do not reflect these modern distribution and shop concepts. In the case of classic retail space use, the turnover allocation can regularly take place without bigger problems but this is more difficult in today's omnipresent multi-channel concept. It is obvious that – depending on the point of view – the point of sale as decisive for the allocation of turnover can definitely be seen in different ways. Is the turnover with the client generated on the internet – virtually at the mouse 'click' – or when picking up the good – at the 'collection-point' – in the stationary retail space? How is a return of the good by the customer at the stationary unit dealt with? Is this a turnover rent relevant turnover in the lease object or not?

The answers to these questions are economically important for both the landlord and tenant of a retail space. The turnover rent to be paid by the tenant, which amounts to a certain percentage of the turnover, depends on where the turnover is generated and, hence, on the answers to these questions.

'Point of sale' – definition as wide as possible

Outdated and traditional contractual provision do not help in this case – at least from a landlord's vantage point. Following this, from a landlord's perspective, contractual stipulations in lease agreements have to be developed, which define the point of sale as wide as possible. Such provisions, of course, can only be enforced in practice if they are combined with technical recording and reporting obligations for the tenant, and the inspection and supervision, as well as sanction rights for the landlord. Otherwise, the landlord has neither practical power in order to determine the turnover realised in the lease object validly nor is he or she in the position to practically enforce these provisions. Taking this into account, such provisions represent a cash flow optimising method, which leads to an immediate economic advantage for the property owner, in particular in the context of financing and potential exit strategies.

Hence, all parties dealing with this subject matter, especially developers, property owners, financial institutions and operators of retail real estates, including their advisers, are well advised to inspect their contractual documents regularly and from an innovation ability and flexibility perspective. Only if these requirements are met will it be possible in the future to ensure sustainability and innovation ability for retail spaces permanently.

A flexibilisation of the legal agreements within this meaning on the one hand and operative-economic planning security on the other hand do not have to interfere with each other. In particular, rental documents, which are innovative and give tenants needed flexibility, can be crucial for successful development, financing and marketing as well as for a successful operation of the retail real estate.

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Argentine Unified Civil & Commercial Code: impact in the real estate market

From the 1860s until 2015, two codes ruled the daily lives of Argentine citizens, as well as the existence and activity of the companies doing business in Argentina: the Civil Code and the Commercial Code.

Many attempts to unify the two codes have been made in the last few decades, though without success. However, on 1 October 2014, Law 26,994 was enacted, which derogated both the Civil and Commercial Codes, and 'created' a new Unified Civil and Commercial Code (the 'Unified Code'), which came into force as of 1 August 2015.

This new Code is having a huge impact on Argentine legislation and especially in law practice because together with the derogation of the two codes, more than 150 years of jurisprudence and doctrine were derogated as well. In other words, until last year, any decent corporate lawyer in Argentina knew the Civil and Commercial Codes almost by heart, and knew not only what the jurisprudence had interpreted on any specific article, but also what the most knowledgeable experts had written and stated about any specific matter. With the enactment of the new Unified Code, we lawyers are carefully analysing and discussing the impact of this new code, the scope of which – as said – is key to everyone's lives. And further, we are all waiting to hear how judges shall interpret its regulations. We understand that a 'new jurisprudence' will be generated within the next five to ten years, and in the meantime, we lawyers will be key to that interpretation.

The purpose of this article is likewise to mention just a few of the changes that the new Unified Code shall have on the regulations applicable to the real estate market:

- The new Unified Code created a new 'right of surface', which will no doubt be a very attractive tool to develop projects where a construction capacity is available and subject to be commercialised (ie, not only in pieces of land, but also in buildings already built).
- Some new property rights were further created, among them, the condominium right (ie, *propiedad horizontal*), which amended the rules existing before regarding those types of rights. Such a new 'condominium right' is the one to rule on the development of all closed neighbourhoods, no matter whether they are plain gated communities (ie, *barrios cerrados*) or country clubs (ie, *clubes de campo*). Further, the new Unified Code foresees that all closed neighbourhoods not priorly organised as per the rules of the new condominium right, shall have to adapt their legal structure accordingly (ie, there is not much information available yet regarding the compliance to this requirement).
- Trusts: real estate trusts have been the most popularly vehicle for structuring real estate projects during the last 15 years. With the new Unified Code, the structure of these trusts shall have some amendments that shall not affect their existence nor application, but nevertheless shall have to be borne in mind. Among others, we may find the following:
- Trust agreements shall be registered before a registry to be developed by each jurisdiction. However, there is no further information available about this obligation.
  - Trustees may be beneficiaries of the trust (which in the prior regime was subject to discussion).
  - Trustees shall retain civil responsibility insurance to cover damages caused by the goods under trust. This, among other facts, shall cause the 'creation' of an insurance that still does not exist.
  - If the trust shall be offered to the public, the trustee shall be a financial entity. This has not been the case in the majority of real estate projects in the last few years in Argentina, although having, in fact, been offered to the public.
  - The trust may be revoked by the trustor, if that possibility is expressly foreseen in the agreement. The revocation shall cause the

extinction of the trust (ie, this possibility did not exist in the law in force before).

- Companies with just one shareholder shall be accepted (ie, they were forbidden in the prior system). These companies shall be organised as corporations (ie, '*sociedad anónima*').
- Lease agreements shall 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 ten-year term of the prior law had proved to be insufficient in many cases (eg, when a future lessee had to make a big investment, the ten-year term usually turned out to be very short and inadequate to amortise the capital invested).
- In construction agreements, the owner shall be able to amend the project without the constructor's agreement, as long as those amendments do not affect 'substantially' the nature of the work. We can imagine the inconvenience that may be faced here on the definition of what would be 'substantial' and what would not.
- Before, 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 shall also have responsibility. We gather that new insurance policies will have to foresee the coverage of these new responsibilities.

As described, the new Unified Code has brought many amendments to the laws and regulations that applied to the real estate market (ie, 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 us lawyers to be innovative on the new legal scenario that will appear before our eyes.

Foreign vendors and purchasers stung by new tax withholding regime for Australian property transfers

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From 1 July 2016, a new foreign resident capital gains tax (CGT) withholding regime will be in effect in Australia. Under the regime, introduced by the Tax and Superannuation Laws Amendment (2015 Measures No 6) Act 2016, purchasers of certain property assets from foreign resident vendors must withhold an amount equal to ten per cent of the purchase price and remit it to the Australian Tax Office (ATO). The purchaser must remit the withheld amount on or before settlement.

In general terms, CGT is a tax paid on capital gains as opposed to income. A capital gain (or loss) on an asset is determined by calculating the difference between the price paid for the asset and the price it is sold for. A capital gain is included in a person's assessable income for the relevant tax year. The amount of gain to be included varies for different types of taxpayers.

The new withholding regime is a response to a lack of compliance with the existing CGT liability regime for foreign residents. Voluntary compliance with the existing regime, which requires foreign residents to pay tax on capital gains made when selling Australian property assets, is very low.[1] The ATO has had significant difficulty collecting CGT from foreign residents under the existing regime, and says the new legislation will 'protect the integrity of the foreign resident CGT regime'.[2]

The regime is broad and wide reaching. It applies to all Australian real property including land, buildings, commercial and residential property, and leases. It also applies to indirect Australian real property interests, where an asset is an interest in an entity whose major assets consist of Australian real property. The withholding regime also applies to options or rights to acquire any of the above assets.

A vendor or registered proprietor of the above assets is deemed to be a 'foreign resident' unless he or she can provide the purchaser with documentation that proves the individual is an Australian citizen or that the asset is not an indirect Australian real property interest. A vendor is also taken to be a foreign resident if a purchaser knows or reasonably believes the vendor is a foreign resident, or does not believe the vendor is an Australian resident.

There are exemptions. To avoid capturing the majority of residential house sales, the regime does not apply to real property or indirect interests worth less than AU$2m. Further, it does not apply to transactions on an approved stock exchange or to certain situations where the vendor is bankrupt.

What are the practical implications?

The new regime has been criticised for taking a sweeping approach to the isolated problem of foreign resident vendors avoiding CGT liability. All purchasers and vendors of Australian property assets are affected by the regime, and there are concerns from the legal industry that the measures create red tape and will adversely impact the operation of property transactions.[3] A key issue is the significant increase in administrative and compliance costs likely to occur as a result of the regime's requirements.

The Law Council of Australia, the Law Institute of Victoria and the Law Society of New South Wales have requested that the implementation of the regime be pushed back to July 2017. Although these organisations agree with the Federal Government's aim to increase foreign resident CGT compliance, they maintain concerns about its practical operation, particularly that it 'will generate uncertainty, delays and a significant administrative burden for Australians who purchase Australian property from foreign interests and Australians who purchase real estate with a market value of $2 million or more.'[4]

The administrative burden is apparent from the practical operation of the regime. Purchasers must ensure they meet their obligations to avoid incurring significant penalties, both criminal and administrative, for failing to withhold the required amount. Purchasers must withhold ten per cent of the purchase price unless they are provided with a clearance certificate or vendor declaration.

Vendors of real property or indirect Australian real property interests can apply for a clearance certificate. Clearance certificates are issued by the ATO and confirm the Australian residency tax status of the vendor. Vendors of options and rights to acquire real property or indirect interests can provide the purchaser with a vendor declaration. There are two types of declarations; a declaration that the vendor is an Australian resident, and a declaration that the interest being disposed of is not an indirect Australian real property interest.

Vendors must ensure that they provide one of these documents if they want to receive the full purchase price, or may apply for a variation to the withholding rate if, for example, no capital gain will be made from the transaction. Vendors who make false statements or do not take reasonable care in making a declaration may incur penalties. Purchasers can rely on clearance certificates and vendor declarations and will not be required to withhold the required amount if they receive one of these documents. However, if a purchaser believes a vendor declaration is false, he or she must withhold the required amount.

It is unclear from the legislation whether options and rights that are themselves worth less than AU$2m to acquire assets are exempt from the regime, with the potential consequence that all options and rights to acquire Australian property, regardless of their value, are subject to the regime's administrative hurdles and withholding obligations.

Conclusion

The above concerns about the new regime indicate that its significant impact on vendors, purchasers and their representatives has not been fully considered. Foreign investors should be aware that as the practicalities of the regime are clarified there is likely to be further change in this area.

Notes

1 Parliament of the Commonwealth of Australia House of Representatives, Explanatory Memorandum, Tax Superannuation Laws Amendment (2015 Measures No 6) Bill 2015), *Ch 2.2.*

2 Australian Tax Office, Foreign resident capital gains withholding payments, www.ato.gov.au/General/New-legislation/In-detail/Direct-taxes/Income-tax-for-individuals/Foreign-resident-capital-gains-withholding-payments/

3 Law Council of Australia, Law Institute of Victoria and Law Society of New South Wales, Submission to the Assistant Treasurer, Foreign resident capital gains withholding payments, 3 May 2016.

4 *Ibid.*

Leasehold: what is new in Austria and neighbouring jurisdictions

AUSTRIA

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In Austria, the owner of land is in principle also the owner of the building on the respective land (*superficies solo cedit*). In the case in which a building is constructed on land owned by third parties, and notwithstanding any other agreements, the owner of the land in question becomes *de jure* the owner of the building as well. Having said this, there are two major exceptions that make it possible in Austria for legal ownership of land and the building thereupon to be in different hands. One exception is what is called building on third party land (*Superaedifikat*) and the other is named construction right (*Baurecht*/ leasehold) pursuant to Building Law Act 1912, which both make a separation of ownership of building and land possible. The Baurecht structure in particular is becoming more and more popular.

Building on third party land (*Superaedifikat*) and construction right (*Baurecht*)

The *Superaedifikat* and *Baurecht* have substantial differences, which are crucial for deciding which of those two legal instruments should be used. However, as mentioned above, the similarity is that the landowner does not sell the land, but provides it for compensation to an investor for a certain amount of time (long-term), who constructs a building on the land.

- The *Baurecht* arises from the entry into the land register. The *Baurecht* is a so-called right in rem over immovable property (*dingliches Recht*), which – no matter who is the respective landowner – remains valid and can be mortgaged independently and completely transparently.
- In contrast to this, a *Superaedifikat* arises only with the construction of the building. Although the legal position of the *Superaedifikat* owner can be improved by deposition of documents into the land register, an equally strong and direct position emerging from the land register and the easy mortgaging possibilities that a *Baurecht* owner has will not be achieved.
- Furthermore, the Building Law Act rules that the building is transferred to the landowner after expiration of the designated time (between a minimum of ten and a maximum of 100 years) and the landowner must pay compensation to the building owner in the amount of 25 per cent of the existing building value. This regulation is not mandatory, so various options are possible.
- Regarding the *Superaedifikat*, no statutory parameters exist that impose the transfer to the landowner after the expiration of the designated time. Nevertheless, after the expiration of the designated time of the *Superaedifikat*, the landowner also becomes the owner of the building.

What are the positive and/or negative aspects of the *Baurecht* from the landowner's point of view?

The owner of the land could be interested in providing the property for use for a certain period of time, but not cede ownership for a number of reasons. The following motives are conceivable:

- The landowner is not permitted to sell the land due to a provision binding the owner to the land, for example, a company statute, a foundation provision or a testamentary provision.
- The landowner would be permitted to sell the land but chooses not to as a matter of principle. Often, churches or the nobility choose not to sell their land for this reason.
- The landowner does not want to trade the investment in the land with alternative assets (eg, stock) and primarily would like to generate an increase in the value of their land.
- Furthermore, the landowner could speculate to obtain the building constructed after the expiry of the contract for an advantageous price or even for free.
- As always, fiscal considerations could be decisive.

The main disadvantages for the landowner are:

- First and foremost, the landowner generally cannot simply get rid of the *Baurecht* for no reason and therefore he/she is not free to use the property as he/she would like to (eg, to construct a building or use it for other purposes).
- Besides, it is evident that the landowner would not obtain the same amount by implementing a *Baurecht* as he or she would by simply selling the land. Having said that, depending on the compensation the building right's owner would have to pay and the time period of the *Baurecht* agreed upon, it is possible that the landowner ultimately earns more from the *Baurecht* (than he or she would get from the sale of the land).
- Finally, a landowner would always have to take into consideration the substantial amount of time for which a *Baurecht* is usually implemented (as mentioned before: a minimum of ten years and a maximum of 100 years). Even though the minimum duration is less than in other European countries (eg, in Switzerland, the *Baurecht* has to be implemented for at least 30 years) it is nearly impossible to assess the market situation for such an amount of time (up to 100 years) in advance. Moreover, there is always the risk (which cannot be mitigated by, for example, contractual provisions in any case) that the building right's owner becomes insolvent. This could lead to a situation in which the landowner is confronted with a developed property, but the building cannot be sold or used (eg, because of a lack of investment by the building right's owner). In this case, the landowner would have to bear the costs to tear down the building with no compensation.

What are the positive and/or negative aspects about the *Baurecht* from the point of view of the investor/the (soon to be) owner of the construction rights?

For the relevant investors (the ones who wish to obtain the construction rights), the following aspects regarding the question of why they should/could invest are conceivable:

- On the one hand, there are some landowners who would not be willing and/or not be permitted to sell the property.
- In addition – and this is widely conceived as the major advantage of the *Baurecht* – the initial costs for being able to build are normally much lower than the costs that would arise if one had to buy the respective land. Nevertheless, it should be noted that depending on the actual compensation the investor would have to pay to the owner of the land regarding the total duration of the *Baurecht*, the usage of this legal instrument can also be more expensive than the acquisition of the land.
- In the industrial sector, ownership of land normally is not essential for the mere management of a building (eg, construction of a factory).
- In comparison to a *Superaedifikat*, a *Baurecht*-project (when the other parameters are fine) can normally be financed by banks. This mainly depends on the legal arrangements of the contractual agreements and the statutory provisions behind them.

The main downside for the investor is obviously that generally after the termination of the *Baurecht*, the investor loses his or her ownership of the building (in exchange for relatively little compensation). In this regard, it has to be noted that this disadvantage must be looked at: (1) considering the usually long term of a *Baurecht*; and (2) keeping in mind that the investor and respective owner of the land can agree upon, for example, fixed compensation for the building higher than the one stipulated by law.

Current developments

It seems that in Austria, especially in its capital Vienna, the *Baurecht* is becoming more and more popular. Some politicians want the City of Vienna to follow the example of the Catholic church and to stop selling larger pieces of land, but instead give out *Baurechte*, as this would mean that the city does not lose its proprietorship. In Vienna, there are some examples of larger projects that were handled using the *Baurecht* instead of selling (eg, the Otto-Wagner-Areal).

Although, seemingly, the tendency is heading in the direction of giving out more *Baurechte*, apparently the city is yet to follow this mindset. To make the *Baurecht* even more attractive, the lawyers', landowners' and legislators' contribution is needed. To reach this goal, the rights of a building owner must be (even more) like that of a 'normal landowner'. Furthermore, it seems to be necessary to motivate the building right's owner to invest in the building; this goal can be reached if the building right's owner:

(1) has the obligation to invest; and/or (2) can benefit from the value of the building when the *Baurecht* ends (ie, get higher compensation).

The situation in Germany and Italy

Germany

Even though the German equivalent to the *Baurecht*, the so-called *Erbbaurecht,* has a lot in common with the one described above, there are some important differences.

In contrast to Austria, where the *Baurecht* can only be established for a maximum of 100 years, in Germany there is no limitation of time periods; therefore, the possibility of an 'eternal hereditary building right' exists.

Apart from that, whereas in Austria a successful contestation of the contract (with which the *Baurecht* was implemented) generally leads to the forfeiture of the *Baurecht* (ie, the separation of ownership of the building and the land ends), in Germany this is not the case. Having said that, in both jurisdictions, the building right's owner loses his/her *Baurecht/Erbbaurecht.*

Italy

Some kind of *Baurecht* also exists in Italy – *il diritto di superficie* – which is regulated by the Italian Civil Code.

In Italy, similar to the German *Erbbaurecht* and contrary to the Austrian *Baurecht*, there is no limitation of time periods for the *Baurecht.*

Furthermore, in Italy (with the exception of the northern parts of the country, which were once Austrian territory) land ownership can be transferred simply by making an agreement (principle of consensus or *principio consensualistico*), whereas in Germany and in Austria the transfer of land only becomes effective with the registration of the transfer in the land register. This also applies to the acquisition of a *Baurecht.*

What if the land term expires in China?

CHINA

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Recently, homeowners in Wenzhou City, Zhejiang Province were requested by the local land and real estate authority to pay a land premium equal to one-third of the price of their respective homes to renew the term of the land-use right. Homeowners in China are now forced to realise the brutal reality that they may be obliged to pay additional land premiums after the expiration of current land use, which is 70 years in general but in extreme cases less than 70 years. This has aroused widespread concerns and debate in public.

China has promulgated a series of laws and regulations to regulate and administrate the renewal of the granted land-use right for residential housing, including the Property Law of the People's Republic of China (the 'Property Law'),[1] the Urban Property Administration Law of the People's Republic of China (the 'Urban Property Administration Law'),[2] and the Interim Regulations of the People's Republic of China Concerning the Assignment and Transfer of the Right to the Use of the State-owned Land in the Urban Areas (the 'Interim Regulations'),[3] which provide:

- The term of land granted for residential land is 70 years, the term of land granted for industrial use is 50 years, and the term of land granted for comprehensive and other purposes is 50 years.[4] Upon the expiration of the term of use, the land user has the right to apply for its renewal, but the land user is required to enter into a new land grant contract, pay the land-use right grant premium and undertake registration.[5]
- Article 22 of the Urban Property Administration Law states that '[w]here the term for the use of land specified in the land grant contract expires, and the land user needs to continue the use of the land, the land user shall apply for an extension of the term no later than one year ahead of the expiration. Such an application shall be approved excepted for the land reclaimed

as required by public interests. Upon approval of the extension, the land user shall enter into a new land grant contract and pay fees for the granting in accordance with the relevant regulations. Where the term for the use of the land specified in the land grant contract expires, and the land user has not applied for an extension of the term or his application therefore is not approved in accordance with the provisions in the preceding paragraph, the land-use right shall be reclaimed by the State without compensation.'[6] That is, where the term of the granted land-use right expires, the residential property owner is required to enter into a new land grant contract and pay a land premium to renew the term, otherwise, the land-use right will be reclaimed by the state without compensation upon expiration.

Nevertheless, the Property Law categorises different types of land and regulates the renewal of the land-use right based on the different types of land.[7] Article 149 of the Property Law states that '[w]hen the term of the land-use right for residential land expires, the term shall be automatically renewed.'[8]

It is noteworthy that, even though the term of the land-use right for residential land can be automatically renewed upon expiration, the Property Law does not specify the methods and procedures of the automatic renewal and whether a further land premium will be charged for the renewal. In view of the history and legislative intention of adopting Article 149 of the Property Law, the legislature intentionally left the relevant renewal issues for future clarification and regulation.[9]

On 19 April 2016, the Urban Planning, Land & Resources Commission of Shenzhen Municipality issued a memo that clearly provided that any land-use right that was granted before 18 September 1995 can be renewed for free to a maximum term stipulated by the state law; however, the memo was silent on the relevant issues of renewing a land-use right that was granted after 18 September 1995.[10] So far, this is the only local administrative authority in China that has issued a memo specifying the relevant renewal procedures and fee collection requirements with respect to the renewal of the land-use right.[11] However, it is worth noting that this practice in Shenzhen was originally intended to cure legislative defects in Shenzhen's development history in that the term of land-use right in Shenzhen was only 50 years,[12] much shorter than the term allowed by the state legislature.

With respect to the necessity of charging a land premium and how much the government should charge, scholars have different points of view. The conservative point of view is that the government should charge a nominal amount for land-use right renewal,[13] whereas many other scholars supported that the renewal of the land term for residential housing should be free of charge.

The renewal of the term of the granted land-use right for residential housing and the relevant issues regarding the renewal fees have been under heated academic debate recently. The state legislature is recommended to start enacting the implement rules of the Property Law to specify and regulate the relevant renewal issues as soon as possible.

Notes

1 Promulgated by the Standing Committee of People's Congress (the 'Standing Committee'/the 'Legislature') on 16 March 2007.
2 Adopted by the Eighth Meeting of the Standing Committee of the Eighth National People's Congress on 5 July 1994 and amended by the Twenty-Ninth Meeting of the Standing Committee of the Tenth National People's Congress on 30 August 2007.
3 Promulgated by the State Council of the People's Republic of China on 19 May 1990.
4 See Art 12 of the Interim Regulations.
5 See Art 41 of the Interim Regulations.
6 See Art 22 of the Urban Property Administration Law.
7 See Property Law (2007).
8 See Art 149 of the Property Law.
9 Details with respect to adopting the 'automatic renewal for the land-use right for residential land' stated in Art 149 of the Property Law, see: http://mp.weixin.qq.com/s?__biz=MzIwNjA4MDk2Mg==&mid=2650428423&idx=1&sn=e7565cea7dbc5e1404bac8f4c132aaf7&scene=2&srcid=0425t1RHfcqD94Lx2VvfqQQE&from=timeline&isappinstalled=0#wechat_redirect.
10 See: http://weibo.com/u/2858032360?is_hot=1#_loginLayer_1464762662469.
11 *Ibid.*
12 In 1988, the Shenzhen Legislature promulgated the Provisions of Shenzhen Special Economic Zone on Land Administration (the 'Provisions of Shenzhen Land Administration') and provided that the term of the granted land-use right is 50 years; see Art 16 of the Provisions of Shenzhen Land Administration.
13 See 'Shenzhen Municipality Formally Specified Rules for Renewing the Land-Use Right – Qualified Land Can be Renewed for Free' (25 April 2016) China Real Estate News.

Foreign real estate investment in the Dominican Republic

DOMINICAN REPUBLIC

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Abstract: For the purpose of real estate investment, the Dominican Republic treat foreign investors as local investors, and they can buy real estate thorough the Dominican territory without restrictions, even in touristic and maritime locations.

Over the last two decades, the Dominican Republic (DR) has become one of the most rapidly growing economies in Latin America with a mean growth rate of 5.4 per cent gross domestic product (GDP) between 1992 and 2014. DR still has the fastest growing regional economy for 2014 and 2015, at seven percent GDP. The recent growth has been trigged by the manufacturing and tourism industries. In 2016, growth is expected to be 7.3 per cent GDP.[1]

Concerning direct foreign investment (inversión extranjira directa IED as per its Spanish initials), DR has become the regional epicenter to attract IED. The investments obtained in DR for 2015 represented 37 per cent of all investments received in the Caribbean, strengthening it as the largest IED receptor in Central America and the Caribbean.[2]

To achieve this satisfactory business environment, the legal system has played a basic role, which offers the following advantages: (1) fair treatment for local and foreign investors; (2) repatriation of 100 per cent of profits; (3) free convertibility of funds; (4) free access to international currency in local commercial banks and the Central Bank; and (5) a fast and easy registration process.

The real estate industry is no exception and foreign investors are treated the same as local investors, and they can buy real estate throughout the Dominican territory, even in touristic and maritime locations. The only exception is for the border region, on which the constitution forbids foreigners buying real estate.

To purchase real estate in DR, foreigners do not need to be resident nor need a local partner. Such a purchase can be carried out through a natural person, or a local or offshore company.

Once the purchase is completed, the alien citizen has the full and absolute ownership on the real estate, with all the same use and disposition rights to which Dominican citizens are entitled.

Further, according to Law 171-07 on incentives to retired people and foreign source rentiers, real estate investors can obtain a resident permission in 45 days.

In addition, the real estate industry has been promoted significantly by a number of government measures to stimulate tourism abroad and give significant tax incentives to investors by Law No 158-01 on Tourist Development Promotion. This law has as the basic aim to develop the tourism industry in a reasonable and sustainable way in some locations of our country by several attractive tax opportunities for those investors desiring to be engaged in this field. Among those worth mentioning are the tax exemption for ten years of 100 per cent on the taxes for income, capital gains, company incorporation and capital increase, real estate transfer and real estate property. Moreover, this law exonerates a 100 per cent of custom taxes or goods importation taxes, movables estates, equipment and material needed for building and setting up the real estate facilities purchased.

Notes

1 Dominican Republic, World Bank: www.worldbank.org.
2 Foreign Direct Investment in Latin America and The Caribbean 2016, Economic Commission for Latin America and the Caribbean. See: www.cepal.org.

FRANCE

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Sale of commercial assets and proof of commerciality

In France, the sale of commercial assets requires the seller to prove its commercial nature.

Under French legislation, residential assets may not be used for a commercial purpose without prior authorisation.[1] This authorisation could be either granted or refused against financial compensation. This authorisation can also be granted if there is a commitment by the owner to assign another commercial asset into the residential sector.

Pursuant to an order dated 8 June 2005,[2] this regulation has restricted the freedom related to the change of use of residential assets where the aim is not to aggravate the residential shortage in France, particularly in the capital, and to preserve as much as possible the number of assets destined for residential use.

The risks of violating regulations are the following:

- nullity of agreements;[3]
- a fine of €25,000;
- the penalty can be up to €1,000 per day per square metre for assets whose use was improperly changed, after the deadline set by the judge for the regularisation of the property to a residential use has expired.

In the case of an investment operation, potential buyers should pay close attention to the registered use of the asset, and it will be the seller's obligation to prepare all documentation proving the commercial nature of the asset in order to avoid any delay and future inconvenience with a buyer acting in bad faith.

It should be noted that Article L 631-7 of the French Construction and Housing Code specifies that the 'assignment can be established by any form of evidence'; nevertheless, potential buyers may question the documentation presented by the buyer at any time under the pretext of being not sufficient, making abusive and excessive requests in order to renegotiate the terms and conditions of the operation.

It is important to outline that in the case of a dispute, the commercial nature of the asset will be determined by the judge.

The question that arises is how to demonstrate to future buyers, as securely as possible, the commercial nature of an asset and the elements required to justify this commerciality.

The legislation distinguishes between assets built before or after 1 January 1970.

Assets built before 1 January 1970

In accordance with Article L 631-7 and following the French Construction and Housing Code, assets can be used for either residential or non-residential purposes. Assets are deemed to be residential if they had such use on 1 January 1970, and if they have not been subject to a change of use due to an urban permit or to compensation, this assignment can be established by any form of evidence.

Until 1 March 2016, the *déclaration de révision foncière de 1970* (use of the asset declared by the owner during the land reform) was considered to be almost irrefutable evidence when demonstrating the purpose and use of the asset.

The French administration considers that in the framework of the annual update of constructed land, owners are obliged to declare a new statement to report any new changes of use, construction, and soon, relating to their properties. This new and updated information should replace all previous information appearing on previous statements held by the administration that had become obsolete. Consequently, the *déclaration de révision foncière de 1970* will no longer constitute the legal basis of taxation, as the latter is no longer issued by the administration.

Therefore, in the case of assets built before 1 January 1970, their commerciality will have to be evidenced by any other means, such as, for example, tax returns for local taxes, land register certificates, leasing contracts, land registry documentation, registered property deeds or joint ownership agreements.

It should be noted that in order to confirm the use of assets built before 1 January 1970, it will be necessary to verify with the administration the following:

- that the assets have not been offered in compensation since 1 January 1970;
- that the assets have not been subject to a change of use due to an urban permit since 1 January 1970; and
- that the assets have not been the subject of a request for temporary assignment to housing under the provisions of former Article L 631-7-1 of the French Construction and Housing Code, an article that has not been extended by the order of 8 June 2005.

Assets built after 1 January 1970, or built before 1 January 1970, subject to a construction permit

Article L 631-7 of the French Construction and Housing Code contemplates that for assets built after 1 January 1970 or those built before 1 January 1970, but have been the subject of construction works having the effect of changing its destination *are deemed to have the use for which the construction or work was authorised.*

In this case, it will be necessary to obtain the pertinent administrative authorisations related to construction works, to prove the commercial use of the asset.

To conclude, it should be recalled that until 2005, in the case of rented assets, evidence was required of an uninterrupted chain of commercial leases between the date of the document proving the commercial use and the date of the sale. In the case of a rupture of this chain, the property would automatically revert to residential use. After 2005, this uninterrupted chain is no longer required.

Obtaining the documentation to justify the commercial nature of an asset could take a lot of time; therefore, it is advisable to be as prepared as possible before the acquisition audit phase in order to avoid any inconvenience.

Notes

1 Article L 631-7 of the French Construction and Housing Code.
2 Order No 2005-655 of 8 June 2005 on construction and housing.
3 L 631-7, al 5 of the French Construction and Housing Code.

Standardisation is key to the efficient management of real estate transactions

GERMANY

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One of the world's most important growth markets is commercial property, and the need for compliance and process efficiency within this area is steadily increasing. This is due to an ever-changing and volatile market environment, and the growing demands that regulators and investors make of real estate companies, banks, funders and insurers. The inefficiency of the existing processes, together with increased transaction volumes, adds impetus to the pressure to improve the due diligence processes.

The need for efficiency in the real estate market

To ensure a smooth market structure through standardisation and improved transparency, the German gesellschaft für immobilienwirtschaftliche forschung (ev) gif association (German Society of Property Researchers) has issued a recommendation for the standardisation of commercial real estate data rooms. This recommendation is geared towards all real estate vendors in Germany, and has specific requirements relating to the structure of data rooms for real estate transactions.

Vendors will receive an index template that is suitable for both the potential buyer's examination of the purchase and contractual documentation between the parties. Furthermore, the recommendation covers other important aspects of commercial real estate, such as the technical and legal requirements of a data room, the correct naming of documents, update management and security.

Standardised real estate data rooms

The centrepiece of the recommendation is a standardised index. It is not overly extensive, but it does contain all the essential elements for real estate transactions. Although the gif is a German association, the index it recommends will also work on an international level.

The index would be the core element of a data room because it structures the whole content of a transaction, and would fulfil the requirements of due diligence for average real estate. It is possible to extend the index, but it should not be shortened.

The relevance of each of the index's components will depend on the specifics of the assets involved in the transaction. The index aims to facilitate the separation of the property, the company and financing. Items 2 and 3 will be irrelevant for some asset deals so can therefore be left out. However, if items 2 and 3 are relevant, then the recommendation provides a structure, which should be maintained.

The main points of the index are:

1	Property-related documentation
1.1	Introduction
1.2	Site
1.3	Ownership
1.4	Construction planning law
1.5	Building regulations law
1.6	Building (technical management)
1.7	Tenancies
1.8	Management (commercial)
1.9	Taxation
1.10	Legal disputes
1.11	Object-related contracts
1.12	Additional information for special purpose properties
1.13	Other documents / contracts / agreements
2	Legal entity documentation
2.1	Legal entity
2.2	Articles of association
2.3	Shareholders' resolutions
2.4	Management board
2.5	Entity related contracts
2.6	Land purchasing contract
2.7	Financial information
2.8	HR
2.9	Joint ventures
3	Financing

The index provides the contracting parties with a satisfactory and reliable basis to establish a well-structured data room. It is the first time definitive guidelines to regulate the standard structure and required content of a data room have been agreed. This is despite the fact that data rooms are generally very similar for all commercial real estate transactions. One of the consequences of the lack of standardisation has been unnecessarily long waiting times for the integration of data during the progression of a deal. These delays can make transaction costs soar.

The significance of standardisation, which facilitates efficient due diligence processes and therefore helps keep down the overall transaction cost, should not be underestimated. All parties involved in transactions can benefit from standardisation by reduced costs and saved time. Therefore, the recommendation of the gif is to establish a new standard for real estate transactions. A comprehensive implementation will ensure comparable due diligence processes, which will make life easier for the buyer, vendors and portfolio manager.

Experts from Centrum, Clifford Chance, Drooms, GE, JLL, Nexus and UBS were involved in the development of the recommended data room standards. These experts were all able to provide a different perspective on the topic, and they each offered extensive experience in the sale and purchase of commercial property.

ITALY

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New regulation in Italy concerning the acquisition of real estate assets by the lenders in the event of default of the borrower

On 3 May 2016, the Italian Government adopted Law Decree No 59 of 2016 – entitled 'Urgent Measures regarding Enforcement and Insolvency Procedures, including vis-à-vis investors in banks under liquidation' (the 'Law Decree'), currently in force (but subject to conversion into law) – which has introduced several material innovations with respect to security interests and collection of receivables, in order to facilitate debt recovery and promote new bank lending, in particular, in the real estate market.

In this respect, it must be preliminarily noted that the Italian legal regulation concerning security interests and debt recovery has always been based on two fundamental principles: (1) that any agreement whereby the creditor automatically acquires the ownership of a certain asset in the event of default of the debtor is null and void; and (2) that the debt recovery through forced execution over the assets of the debtor has to be carried out with the intervention and under the control of the judicial authority. Such a legal framework is one of the causes of the difficulty that Italian companies have to face in order to obtain credit from banks. In fact, excessively long periods of forced execution actions make it difficult for creditors to withstand default situations of debtors, which results, inevitably, in a general reduction in the distribution of loans and, consequently, in the circulation of money, especially in the real estate sector, in particular, in a period in which the non-performing loans have reached very high levels.

In this context, the Law Decree has introduced new types of security interests in the Italian legal system based on self-liquidating forms of enforcement.

In particular, with respect to the real estate market, the Law Decree has introduced a new form of guarantee – as a more effective alternative to the traditional granting of mortgages – which substantially consists of the direct transfer to the lender of the real estate property, object of the guarantee, under the condition precedent of the borrower's default under the loan agreement and subject to the determination by a third party of the actual value of the property in order to protect the debtor.

The introduction into the Italian legal system of this transfer clause – generally known also as *patto marciano* – represents a substantive innovation implanted into a previous situation in which the disbursement of the loan was usually accompanied by a mortgage undertaking; therefore, this is an instrument largely deflationary of the judiciary activity, discharging the plaintiff/creditor from the duty of incardinating the enforcement proceeding.

With respect to the application of the *patto marciano*, it must be preliminarily noted that this specific security interest may be agreed only in the loan agreements between an entrepreneur and bank (or other entities properly authorised to grant loans to the public); therefore, it cannot apply with respect to financing granted in favour of private individuals or if the lender is not a regulated entity. The property subjected to the security interest can be land or a building of any kind, owned by the debtor or a third party, with the exception of the home of the debtor/entrepreneur, of his/her spouse or his/her relatives up to the third degree. In addition, this new form of security interest will not have an impact only on future transactions because it can also be introduced in mortgage contracts already existing, in the context of a renegotiation to be concluded through the execution of a specific notarial deed of amendment.

In order to be enforceable, the agreement, including the transfer clause, shall be duly registered in the Land Register. Such registration guarantees the lender against the possibility that, on the same real estate

property, are registered other prejudicial encumbrances (such as foreclosures or mortgages), which might lessen and jeopardise the original right of the creditor.

As a result of the transfer clause, the property offered as guarantee remains within the means – and under the ownership right – of the debtor (or of the third party owner), but if the latter does not fulfill his or her obligation, defaulting it, said property is automatically and directly transferred to the lender. At this point, the bank can even sell the property, without going through a judicial executive enforcement proceeding in civil courts. But, at the same time, the law protects the debtor, providing that the bank immediately returns the difference between the estimated value of the real estate property and the amount of debt still unfulfilled. On the contrary, if the value of the asset is lower than the outstanding debt, the creditor must not pay anything to the debtor.

With respect to the actual enforcement of the security interest, it must be noted that the law defines 'non-fulfillment' as the failed payment lasting for more than six months after the expiration of at least three installments (not necessarily consecutive) in the event of monthly payments, and, in case of installments to be paid with terms longer than a month, the failed payment of even a single installment. If the loan is to be repaid through a single payment (bullet loan), the non-fulfilment occurs in the case of a delay of more than six months after the date of expiry of the loan.

In the event of default of the debtor, the creditor shall notify the debtor (and the owner of the asset, if different) with the declaration of intending to enforce the effects of the transfer clause, and, after 60 days, shall request to the President of the Civil Court where the asset is located to appoint an expert for the appraisal of the value of the real estate property, to be presented in the form of a sworn report. Only afterwards, when the expert has already communicated the value of the property to all the parties involved, the transfer of ownership, from the debtor to the creditor, occurs, and only if the appraised value of the property is lower than the outstanding debt. On the contrary, if it is higher, the transfer of ownership occurs only when the lender has paid the borrower the difference between the appraised value and the amount of the debt.

It must be noted that the debtor is entitled to challenge in court the appraisal of the property made by the expert, but such litigation will be limited to the assessment of the actual difference between the appraised value and the outstanding debt to be paid by the lender to the debtor, while it will not affect the lender's right to become the owner of the asset.

The transfer agreement will be enforceable also in the event of insolvency of the debtor or if the asset is subject to executive procedures started by other creditors. In such cases, the court in charge of the procedure shall assess the default of the debtor and will appoint the expert for the purposes of the appraisal, while the lender shall pay the difference between the appraised value and the outstanding debt to the court, for the benefit of the other creditors.

In light of the above, the new security interest introduced by the Law Decree clearly represents a material innovation, aimed to improve the transparency and efficiency of real estate financing transactions, allowing the creditors to speed up the recovery process of their credits, and, at the same time, protecting debtors from unfair consequences.

Sale-leaseback transactions

LITHUANIA

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Sale-leaseback: definition

Sale-leaseback is one of a number of business financing methods. By entering into a sale-leaseback transaction, the real estate owner (the 'Seller') sells the real estate used in its business operations to an investor (the 'Investor'), who immediately executes a long-term (normally at least 10–15 years and usually triple net) lease of the same property to the Seller. Therefore, the Seller becomes a lessee and the Investor becomes a lessor.

Case study: the Seller's perspective

Credit Suisse

In 2012, Credit Suisse, a Swiss bank, entered into a sale-leaseback transaction with the Qatar Investment Authority (QIA), a sovereign-wealth fund, under which QIA acquired Credit Suisse's London headquarters and leased them back to Credit Suisse under a long-term lease lasting until 2034. Entering into a sale-leaseback transaction has allowed Credit Suisse to:

- quickly raise capital;
- maximise efficient use of its capital; and
- focus on its everyday banking, that is, core, business operations.[1]

Attractiveness to the Seller

The following key benefits of entering into a sale-leaseback transaction for the Seller can be identified:

- *Maintaining focus:* Selling the non-core business asset allows the Seller to focus on its core business activities.
- *Raising capital:* By selling real estate, the Seller raises a significant amount of long-term capital and improves liquidity. The Seller may then use the capital to invest in its business, to satisfy debt obligations, to fund further acquisitions, to replenish working capital, and so on.
- *Strengthening the balance sheet:* If the lease under a sale-leaseback transaction is classified as an operating lease, the Seller's balance sheet may not reflect its rent obligations as liabilities. By contrast, a debt incurred by borrowing from financial institutions will always appear as a liability on the balance sheet. With an improved balance sheet, the Seller may more easily obtain bank funding and may appear more appealing to potential investors.[2]
- *Maximising property value:* In contrast to borrowing from financial institutions at a low loan-to-value (LTV) with a short repayment period, entering into a sale-leaseback transaction should generate proceeds of 100 per cent of the property's fair market value, while retaining the right to operate from the asset for the long term. These proceeds may be used to invest in financially more efficient opportunities that will generate higher yield. Therefore, entering into a sale-leaseback transaction may help the Seller more efficiently use its investment in the property as a financing tool.[3]

The Seller may choose the type of Investor the Seller would like to work with. For example, the Seller should consider whether the Seller would prefer working with the same Investor through the entire lease period so that the Investor (owner of the property) would not change. If that is important, it can be beneficial to work with an Investor experienced in structuring such sale-leaseback transactions and with a long-term investment horizon (holding period) to match the lease. If that is not so relevant, the Seller might seek cooperation with the investment funds whose operations are limited to the shorter term. Such Investors would also have a sound investment track record, however, they would dispose the property in a shorter term due to their investment strategy.

Case study: the Investor's perspective

Stern Group

In 2015, W P Carey, a leading global investor that provides long-term sale-leaseback and build-to-suit financing solutions for companies worldwide, entered into a sale-leaseback transaction for a portfolio of ten automotive retail and service sites in the Netherlands with Stern Groep NV (Stern Group), a Dutch listed automotive group.

Entering into a sale-leaseback transaction has allowed the investor to:

- acquire strategic, well-performing facilities in a great location (around three of the

Netherlands' largest cities), which are among the best performing in Stern's portfolio;
- make an investment generating long-term cash flow and attractive yield; and
- obtain a lessee with strong financial performance.[4]

Attractiveness to the Investor

The following key benefits of entering into a sale-leaseback transaction for the Investor can be identified:
- *Long-term cashflow:* By obtaining revenue from the Seller's rent payments throughout the duration of the lease, the Investor may generate long-term cashflow and secure returns for its investors.
- *Predictable return rate*: In addition to normally offering a higher return rate than a loan arrangement, a long-term lease enables the Investor to estimate rent payments, and property operating costs, and protect itself from downturns in the real estate market.[5]
- *Secure investment:* A sale-leaseback transaction may help the Investor to reduce managerial issues because operating expenses are usually paid by the Seller and reduce the risk of incurring expenses associated with finding a new lessee in the case of the Seller's default. Before entering into a transaction, the Investor may assess factors it deems important, including:
  - lessee's ability to pay rent and its financial strength;
  - yield that the property may generate and quality of the property, including the level of property customisation and its suitability to other lessees after expiration of the lease;
  - importance of the property to the lessee and the probability of renewing the lease.

Structuring the transaction

While entering into a sale-leaseback transaction offers significant benefits to the Seller and the Investor, the success of the transaction depends, among other factors, on its appropriate structure, terms of the lease and assessment of risks. Therefore, the business may face the following issues in structuring a sale-leaseback transaction:
- *Negotiation of lease terms*: The Seller's and Investor's ability to maximise the benefits of entering into a sale-leaseback transaction may depend on the successful performance of the balancing exercise between the Seller's and Investor's interests, including the negotiation of key lease terms, such as:
  - *Rent payments*: While the Seller may wish to obtain a reduction of rent payments upon the occurrence of certain unexpected events, the Investor may seek full payments under all circumstances.
  - *Use restrictions*: While the Seller may wish to maintain absolute flexibility in using the property, the Investor wishes to protect its investment and ensure that the property is being used in a manner that is the least likely to diminish its value. The Investor may therefore wish to restrict the Seller's use of the property.
  - *Property modifications*: While the Seller may wish to maintain as much flexibility as possible in relation to modifications of the property, the Investor may be willing to obtain as much control over these modifications as possible. Therefore, the parties may need to negotiate certain modification thresholds.
  - *Insurance coverage*: The Investor may wish to impose more onerous property insurance coverage obligations on the Seller, which may result in an increase in insurance premiums for the Seller, while the Seller may wish to maintain existing property insurance coverage.[6]
  - *Limitation of liability*: While the Investor, having acquired the property to lease rather than to repair and further invest in it, may wish to impose liability on the Seller for its damage to the property and to significantly limit the Investor's own liability, the Seller may wish to negotiate more balanced limitation of liability provisions.
  - *Performance guarantee*: While the Investor, seeking to protect its interests and to reduce the risk of non-performance of the Seller's undertakings under the lease, may wish such performance to be, the Seller may wish to negotiate more limited performance guarantee provisions.
- *Risk assessment*: Before entering into a sale-leaseback transaction, it is essential to mitigate against foreseeable risks, including insolvency of any of the parties, exposure to potential liabilities and potential recharacterisation of the transaction, which may lead to unintended consequences, including increased tax liability.

In order to maximise the benefits available upon entering into a sale-leaseback transaction, it is crucial to appropriately

structure the transaction so that it meets the Seller's and Investor's expectations and minimises potential risks.

Notes

* This memorandum is written as a general guide only. It should not be relied upon as a substitute for opinion, recommendation or other specific advice.

1 See: www.reuters.com/article/idUSL5E8DK18J20120220; www.egi.co.uk/news/credit-suisse-banks-on-370m-canary-wharf-sale-and-leaseback/.

2 See: www.dlapiper.com/en/us/insights/publications/2014/10/sale-leasebacks-accomodate-buyer-and-seller/.

3 See: www.srr.com/article/sale%E2%80%93leaseback-transactions-financing-alternative-middle-market-companies; https://mandelbaum-sale-leaseback.com/sale-leaseback-financing/benefits-2/.

4 See: www.prnewswire.com/news-releases/w-p-carey-inc-acquires-629-million-stern-group-auto-dealership-portfolio-300176983.html.

5 See: www.ccim.com/cire-magazine/articles/sale-leaseback-solutions/?gmSsoPc=1; www.kirkland.com/sitecontent.cfm?contentID=223&itemId=2500.

6 See: http://rew-online.com/2013/11/27/hot-button-issues-of-sale-leaseback-deals/.

Attention! Pre-emption and limitation on properties

POLAND

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The EU–Poland accession treaty provided for a transitional period of 12 years during which a limitation on the acquisition of agricultural and forestry land by foreigners was in force. A foreigner wishing to buy land in Poland had to obtain prior consent from the Minister of Internal Affairs and Administration. In 2015, 335 consents were issued for the acquisition of 460 hectares of land. Most of the consents were issued in favour of Ukrainian, Belarusian and German purchasers, while the Dutch were the biggest land area buyers, with 86.81 hectares, followed by Germans, with 59.24 hectares. This limitation ended on 1 May 2016.

Since 30 April 2016, the legal rules regarding the acquisition and sale of agricultural and forestry land changed significantly as the new limitations on the sale of agricultural and forestry real estate were introduced. The following reasons were given for adopting these new limitations:

- prevention of excessive concentration of farming land;
- strengthening and development of family farms;
- consolidation of agricultural and forestry land;
- replacing the sale of state-owned land by its lease; and
- the protection against the buy-out of agricultural land by foreigners.

Considering the relatively large definition of agricultural and forestry land, the new regulations might affect more situations than would appear at first glance. The new rules should be taken into consideration when contemplating and/or structuring a transaction involving agricultural land and/or shares of companies owning such properties. The new rules apply to real estate owned by both the Polish state (still an important owner of property), and individuals and private entities. However, the legal regime is very different.

Definition of agricultural land and forest

In principle, the qualification of a given real estate as agricultural, residential, industrial, and so on results from the local zoning plan. Yet most communities in Poland do not have local zoning plans or the existing local zoning plans do not cover the area of the entire community. In such cases, the qualification of whether land is classed as agricultural or something else will result from the entry in the land and building registers (*ewidencja gruntów i budynków*) kept by the commune. Such entries are often not up to date and/or complete regarding the factual and current use of the properties. To illustrate this situation, if a residential/industrial or service building was erected on an agricultural property – in the countryside or in a suburban area – but the entries in the land and building register were not updated, such a property is still classified

as agricultural, despite its different current use. In consequence, the impact of the new regulation is in practice not limited to whether the land is actually used for agricultural purposes but to all real estate qualified as suitable for agricultural use.

Under the new regulations, a forest is defined as: (1) real estate qualified as such in the land and building register; (2) designated as forest in the local zoning plan; or (3) forest covered by a simplified plan of a forest's organisation.

Limitations applicable to state-owned land

The sale of any agricultural real estate owned by the state is suspended for a period of five years, except for:

- properties with a surface under 2 hectares; or
- other properties designated for non-agricultural purposes defined in the local zoning plan; or
- properties situated in special economic zones (*specjalne strefy ekonomiczne*).

Limitations applicable to purchasers of private agricultural land

Agricultural land of a surface larger than 0.3 hectares may be acquired by an individual farmer who:

- is running him/herself a farm smaller than 300 hectares;
- has agricultural qualifications; and
- for the last five years has lived in the community where at least one parcel of his/her farming estate is located.

The above limitations do not apply in the case of acquisitions by: (1) close family members; (2) communes; (3) state treasury; or (4) churches and religious congregations. They also do not apply in cases of inheritance. Acquisition by any person other than an exempt entity requires the prior consent of the President of the Agricultural Property Agency (Agencja Niercuhomo ci Rolnych) (APA). The APA's President shall issue such consent if: (1) there is no possibility to sell the land to an individual farmer; (2) the purchaser will provide guarantees that he/she will perform a farming activity on the purchased land; and (3) the acquisition will not result in an excessive concentration of land.

In addition, the aggregate surface of the acquired property together with the estate already held by the purchaser cannot exceed 300 hectares.

Limitation in disposal

The purchaser of an agricultural real estate larger than 0.3 hectares is not entitled to sell or dispose of it in any way (for example, lease it) for a period of ten years from its acquisition. In particular situations, which are out of the purchaser's control, the court will issue consent for a disposition of the real estate. In addition, the purchaser is committed to cultivate the purchased agricultural land.

Pre-emption rights of the APA

By operation of law, the APA has a pre-emption right on:

- all agricultural land of a surface larger than 0.3 hectares; and
- shares and stocks of companies that own agricultural land of a surface larger than 0.3 hectares, regardless of the importance of the agricultural land for the company's business. This pre-emption right will not apply to stocks of listed companies.

The pre-emption right is performed at the contractual price agreed between the parties to the sale agreement. In the situation when the price does not correspond to the market value, the APA might request to determine the price by an expert appointed by the court. Prior to the acquisition, the APA has the right to review books and documents of the company holding the agricultural land. The information resulting from the company's books' and documents' review shall be considered as secret to the enterprise. The purchase of agricultural land or shares of companies owning agricultural real estate without the consent of the APA is null and void. Again, the fact that the company's business is not related to farming does not waive the requirement of the APA's consent. Should the consent not be obtained, and the transaction completed despite the lack of the APA's consent, the transaction will be null and void.

Other important issues

On top of the above described limitations, the following issues should be kept in mind:

- the amount of the mortgage to be established on an agricultural real estate cannot exceed its market value determined by an expert; and
- in case of change and/or accession of a new partner in a limited partnership that owns agricultural land, the APA has a pre-emption right on such property at market value.

Considering that limited partnerships were often used for tax optimisation reasons, any change of partner and/or restructuring of such partnership will fall under the APA pre-emption right.

Pre-emption right of the State Forests

The State Forests are owned by the Polish State Treasury and under the new legislation they enjoy a pre-emption right and/or buy-out right on private forests. The pre-emption right is applicable to forest sale transactions, whereas the buy-out right applies to dispositions in another form (eg, a donation agreement). These pre-emption and buy-out rights are not applicable to the disposal among widely understood relatives and the inheritance of forests. Notably the pre-emption right and/or buy-out right are applicable to properties qualified for afforestation in the local zoning plan and/or a decision on the condition of land construction and development (*decyzja o warunkach zabudowy i zagospodarowania terenu*). So even if there is no forest on the property but the property is qualified for afforestation, the pre-emption right and/or buy-out right apply to such a property.

Conclusions

Concerns have been raised that the new rules are considerably limiting the ownership of real estate and free trade in agricultural land. This may result in a freeze on the agricultural properties market. Prices of agricultural land are expected to drop as the scope of buyers and the use of such properties are very restricted. The new regulations will affect not only farmers but also developers and other investors who are interested in using agricultural properties for other investment purposes. In any case, the new rules will clearly complicate real estate and M&A transactions.

Portugal: a new hotspot for real estate investment

PORTUGAL

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Abstract

After the financial turmoil of 2008, the resilience of the Portuguese real estate sector was an important factor behind a better than expected performance of the Portuguese economy. Not only were the negative spillover effects from the crisis smaller than in other sectors but also some important legal reforms produced results, thus expanding the number of investors looking for high returns. This article examines the positive impacts of two of the legal reforms that made the Portuguese property boom in recent years but also points out new challenges with new and diverse investment activities, such as student housing or building renovation.

Background

Portugal is currently experiencing profound changes in its economic tissue and became a safe harbour for investment, with attractive yields and a wide-range of other benefits, such as a favourable regime for residency permits, which allows its holders to benefit from free movement within Europe. Combined with modern logistical infrastructure, advanced communication systems and a friendly economic environment, Portugal ranks highly as an investment destination as well as a place to live and work, with an affordable cost of living.

In the wake of the 2008 global financial crisis, Portugal faced several economic and social challenges. This was addressed through a number of measures, including financial stimulus and fiscal adjustment. In May 2011, the Portuguese Government requested financial assistance from the International Monetary Fund, European Central Bank and European Commission. As a consequence, Portugal undertook the implementation of structural reforms and wage cuts. Unsurprisingly, these austerity measures triggered recession; however, they also led to innovation in many sectors of the economy.

Real estate was one such sector, which has increasingly attracted individual and institutional investment. Contrary to Spain and Ireland, Portugal did not face a housing bubble with residential and commercial property prices remaining undervalued vis-à-vis other European countries (Organisation for Economic Cooperation and Development and International Monetary Fund). As a result, Portugal's real estate has consistently improved since 2009, primarily led by foreign investment.

This article analyses some of the legal reforms that have contributed to improving the Portuguese property market. In particular, it will focus on two specific measures that turned the country's legal environment into one of the most competitive in the world. As will be shown, the time is right to invest in the Portuguese real estate market. This is a market that has plenty of opportunities to offer and is open to all players looking for a good deal with very attractive returns and yields.

Non-habitual resident special personal income tax regime

The non-habitual resident (NHR) regime was introduced in 2009 to encourage wealthy foreigners and Portuguese individuals who had been living abroad for a long time to settle in Portugal.

NHR individuals can benefit from the special personal income tax regime for a ten-year period. In order to be eligible for the NHR status, two criteria must be met: (1) tax residency under Portuguese law; and (2) not having been taxed as a Portuguese tax resident in the five years prior to taking up residence in Portugal. To qualify as a Portuguese tax resident, an applicant must stay in Portugal for over 183 days per year, whether consecutive or not. Alternatively, ownership or tenancy of property by 31 December of the same year, in a way that suggests an actual intention to use it as habitual residence.

The NHR regime offers significant tax benefits that are especially attractive to wealthy and retired individuals, including a flat tax rate of 20 per cent, much lower than the local top rate of 48 per cent, on income resulting from a high value added activity (employment or self-employment); and a full exemption of foreign-source pensions from personal income tax, meaning in practice, a total exemption from taxation in Portugal and the country of origin. In addition, there is no wealth tax in Portugal and inheritance exempts spouses and children.

'Golden' residence permit

In October 2012, Portugal established an innovative programme enabling non-European Union investors to access a fast-track residence permit procedure. By the end of 30 April 2016, nearly 3,300 investors had benefited from the golden residence permit programme, with total investment surpassing €2bn, 95 per cent of which had been carried out through real estate.

The golden residence permit programme allows investors to live and work in Portugal and any of the 26 European Schengen Area countries, while maintaining residence in another country.

Pursuant to this programme, an investor can apply for residency with an investment of €350,000 or €500,000 – depending on the property type – making Portugal's golden residence permit programme one of the most accessible visa schemes for foreign investors in the world.

Holders of a golden permit may apply for family reunification, obtain a permanent residence permit after five years and apply for Portuguese citizenship after six years.

New opportunities

After several decades of controlled rents and a rigid renting regime, recent legal changes have finally introduced the possibility to upgrade rental contracts to near market rates and to evict tenants in order to fully refurbish the buildings.

Renovated properties are being used for either investment purposes or short-term leases and tourism purposes. Lisbon and Oporto, the country's trendiest cities, are attracting ever more tourists, thus contributing to the property market boom in the prime locations of both cities.

Building renovation is also expected to benefit from a new round of European funds – under the so-called 'Portugal 2020 Programme' – which will focus primarily on urban renovation credit lines. In addition, under the existing legal framework, renovation works also benefit from an expedited planning permission procedure based on a system of prior communication to the local municipalities.

Portugal is also becoming a top destination for students looking for a unique experience in terms of lifestyle, hospitality and leisure. This has triggered an increase in demand for student housing, which is now being regarded

by investors as an alternative to traditional housing and commercial assets. Local universities are open to discuss real estate projects with investors because the demand for new stock in prime locations and near universities is likely to continue.

This short portrait has intended to highlight how the Portuguese real estate market is full of opportunities and open to new players looking for promising deals with good returns and attractive yields. But opportunities do not last forever. Potential investors should move quickly in order to find the right deals.

Real estate deal triggers competition issue

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During 2015, one major acquisition of real estate property occurred in the Serbian real estate market. A major international bank purchased over 8,000 sqm of space in two office buildings located in the Serbian capital, Belgrade. In fact, the buyer only acquired parts of the buildings; it already owned a significant part of this property. The purpose of the purchase was to localise the bank's management in Serbia in one place. The deal was completed by the end of 2015 after long negotiations with the sellers – four companies that are incorporated in Serbia – with the sound of champagne popping. However, just as the party was warming up and the bank's employees were about to settle down in the newly purchased premises, an unprecedented event occurred – the kind of an event that may have long-term consequences for real estate acquisitions throughout the Balkans region.

In February 2016, the Serbian Competition Commission (the 'Commission') initiated a proceeding in relation to the aforementioned purchase. Based on the reasoning contained in the Commission's conclusion on the initiation of the proceedings, the proceedings were initiated for the purpose of examining the alleged concentration that was implemented, even though it was not approved in accordance with Serbian competition law, and which, based on the assumptions of the Commission, occurred by the purchase of parts of the aforementioned office buildings. The Commission stipulated that the buyer acquired direct control over a part of the seller's estate. Having in mind Serbian competition regulations, the purchase of assets or part of assets may, under certain conditions, represent a concentration. However, in this particular case, the decision of the Commission to initiate the procedure was rather uncommon. From the real estate point of view, the effects of the Commission's decision on the local market and the overall legal certainty in relation to the transactions concerning the purchase of assets and the implementation of Serbian competition regulations could potentially be rather negative for the Serbian economy and the real estate market in general. The Commission's decision may potentially introduce an unsafe environment for any further acquisitions of property because this decision would represent a departure from the previous practices of the Commission. It is for this reason that the practice and rules of the Commission should be consolidated as soon as possible, so as to avoid a scenario in which foreign companies can find themselves demotivated to invest in Serbia, and in doing so, hurt the country's current primary strategic goal. Having said that, without clear rules and legal safety, as seen in the initiation of this petition for concentration, the Commission might be preparing the Serbian core real estate market for some cumbersome times.

By the time this article was submitted for publication, the Commission still had not reached a decision on this matter. No doubt, this is a precedent in Serbian law and practice for both real estate and competition sectors. All we can do at this point is wait for the outcome and hope for the best.

SLOVAKIA

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Shopping for farmland in Slovakia from abroad? Country opens for business now: but not without bureaucracy!

Recently, a new Act on Acquisition of Ownership of Agricultural Land (the 'Act') entered into force, which allows foreigners (including legal persons) to acquire agricultural land in Slovakia under certain circumstances. The Act was adopted as a reaction to the expiry of the transitional period during which non-Slovak residents were excluded from the acquisition of agricultural land situated beyond the borders of the municipalities' built-up areas. The Act introduces a complicated acquisition procedure full of restrictions and exceptions.

First, the acquisition rules introduced by the Act do not apply to certain agricultural land, such as land plots in municipalities' built-up areas irrespective of their type or land plots outside municipalities' built-up areas destined for other than agricultural use.

Secondly, the Act only applies to certain types of transfer of ownership to land, such as transfer against a consideration or certain kinds of transfer without consideration as defined in the pertinent provisions of the Slovak Civil Code.

At the same time, the procedure of acquisition set forth in the Act does not apply in cases of the transferor transferring the land to: (1) an acquirer carrying out agricultural production business in the municipality in which the land is located for a period of at least three years before the date of conclusion of the transfer agreement; (2) a co-owner of an agricultural land plot; or (3) a close person or relative as defined in the corresponding provisions of the Slovak Civil Code.

In order to sell agricultural land according to the Act, the owner is obliged to publish an offer in the register of offers on the website of the Ministry of Agriculture and Rural Development of Slovakia (the 'Ministry's Register') for a minimum period of 15 days. The offer must fulfil statutory requirements and be simultaneously published on the official bulletin board of the municipality where the land is located. Each published offer is effective for a period of six months after the expiry of the publication period. The potential acquirer has to record its interest in the Ministry's Register and inform the owner in writing under the conditions given in the published offer.

In the case of more interested parties, the Act explicitly defines the order of priority in which the respective applicants may acquire the land: As a general rule, only a person who has had permanent residence/registered office in the territory of Slovakia for at least ten years and has been carrying out agricultural production business for at least three years before the date of the conclusion of the pertinent transfer agreement can acquire agricultural land within the above described procedure. In the case of more applicants meeting the above conditions, the order of priority to be applied is as follows:

- applicant exercising agricultural business in the municipality in which the land is situated;
- applicant exercising agricultural business in a neighbouring municipality; and
- applicant exercising agricultural business in any other locality within Slovakia.

If none of the above stated persons has expressed interest or the transfer has not taken place for any reason, the owner is entitled to sell the land to any person meeting the requirement of permanent residence/registered office within the territory of Slovakia for at least ten years.

As the last step, before the conclusion of the transfer contract, the potential acquirer must submit a request for verification of fulfilment of the above-specified legal requirements with the competent district office.

In summary, the conditions for acquisition of agricultural land in Slovakia are now the same both for Slovak residents and foreigners. However, any potential investor should examine all relevant legal requirements before deciding to acquire land plots according to Slovak law.

Moreover, the Act does not extend its applicability to all manners of transfer of the ownership to land; it predominantly applies to contractual transfers and omits certain other changes of title, which can occur *ex lege*. In the latter case, therefore, the statutory acquisition procedure does not need to be followed.

It is worth mentioning that the Constitutional Court of Slovakia has recently accepted a motion to decide on the compliance of the Act with the Constitution of Slovakia. However, the Act remains effective in the meantime.

Ukrainian occupied territories real estate issues remain uncertain

UKRAINE

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Crimea has always been an attractive place for property investments, and a lot of investors from all over the world became owners of various real estate assets there. The annexation of Crimea caused an unprecedented event in the history of modern Ukraine: Russia extended its jurisdiction to the territory of Ukraine. As a result, many investors faced a dilemma: should they keep their real estate or get rid of it? Which steps should they take to ensure that their investment is safeguarded? Which state and which legal system is responsible for protecting the legal title to their properties?

At the same time, warfare in the east of Ukraine brought another challenge for owners of real estate property. While the main issue for investors in Crimean property is to save their own investments from legal uncertainty, for investors in property in the Donbass, it is the physical protection of property and recovery of damages that is of paramount importance.

For both types of investors, a vast number of issues appeared and many of them have not been resolved so far.

Legal framework

A major point of any analysis of Crimea-related issues is that, for now, Crimea has a different status under Ukrainian and Russian laws.

According to the Law of Ukraine 'On Ensuring Rights and Freedoms of Citizens and the Legal Regime on Temporarily Occupied Territory of Ukraine', dated 15 April 2014, No 1207-VII (the 'Law on Occupied Territories') that came into effect on 27 April 2014, the Autonomous Republic of Crimea (ARC) – the Crimean peninsula as an administrative entity – is treated as the temporarily occupied territory of Ukraine. Such temporarily occupied territory is an integral part of the territory of Ukraine, which is governed by the Constitution and laws of Ukraine.

At the same time, the Russian Parliament has adopted the Federal Constitutional Law 'On adoption of the Republic of Crimea by the Russian Federation and formation of new subjects of the Russian Federation – the Republic of Crimea and the federal city of Sevastopol' of 21 March 2014 (the 'Law on the Crimea'), whereby it presumed the existence of two new subjects of the Federation: the Republic of Crimea and the federally significant city of Sevastopol from 18 March 2014 as part of Russia.

The situation is completely different when it comes to the areas of Donetsk and the Luhansk regions, which are not controlled by the Ukrainian government. Those areas were captured by groups of people that are recognised as terrorists by Ukrainian authorities and such groups enact and enforce their own legal rules and do no not recognise Ukrainian sovereignty and the rule of Ukrainian laws over the territories under their control. Thus, one may neither analyse the legal framework on the occupied territories in the east nor predict how legal regulation would be performed in those territories. The situation becomes

complicated with regard to real warfare, which is taking place in some regions of eastern Ukraine.

Survival of real estate titles

The Law on Occupied Territories envisages that ownership rights are protected by Ukrainian legislation and shall be preserved for individuals and legal entities of Ukraine, if the property has been acquired pursuant to Ukrainian legislation.

Pursuant to the Law on the Crimea, documents issued by public or other official authorities of Ukraine, public or other official authorities of the Autonomous Republic of Crimea or the City of Sevastopol before 18 of March 2014 are valid in Crimea and Sevastopol without any confirmation from the public authorities of the Russian Federation and with no limitations in time, except documents with specific expiration dates (construction permissions).

It means that Russia recognises all Crimea related (title) documents issued by Ukrainian authorities before the annexation. Such documents will be valid until the end of their validity period (if any) according to the position declared by Russia on the legislative level. Formally the owners of Crimean real estate are not required to re-register it with the Russian property register. In practice, however, the absence of such registration has enabled illegal alienation of the property by fraudsters and we have become aware of a few such cases.

Key issues of the transfer of real estate located in Crimea

Form and governing law of the contract

According to Ukrainian legislation,[1] the acquisition and termination of ownership rights to real estate in the temporarily occupied territory shall also be carried out pursuant to Ukrainian laws. Any deeds on real estate, including land plots, concluded in violation of requirements of the law or any other laws of Ukraine shall be deemed invalid as of the moment of their conclusion and have no legal power, except such in relation to their invalidity. In other words, if a deed is concluded in violation of Ukrainian legislation, no title transfer to the new owner takes place. Moreover, from the Ukrainian perspective, the transfer of title to the Crimean real estate should be executed via the Ukrainian real estate register only.

At the same time, such Ukrainian deals shall be void from the Russian perspective. Under Russian legislation,[2] ownership and other rights in rem over real estate and transactions with them shall be subject to state registration in the Unified State Register of Rights to Real Estate and Transactions. Also, the Russian cadaster system for real estate records includes information on the land plots and has a different structure in comparison with the Ukrainian system.

In other words, the transfer of the real estate located in Crimea under the Ukrainian law will not be recognised in Russia, while appropriate deals in Russia will be in violation of Ukrainian law and actual recognition of the annexation of Crimea by Russia. Obviously, Ukraine would not recognise a transaction with regard to a Crimean property conducted in line with Russian requirements.

Sanctions

In response to Russian policy in respect of Ukraine, personal and sectoral sanctions were imposed on specified persons operating in various sectors of the Russian economy. Sectoral sanctions were mostly focused on financial relations between United States entities and major Russian financial and energy companies. Such measures have envisaged restrictions of transactions, financing and deals with debt instruments of specific Russian companies. In terms of US sanctions, any deal with Crimean real estate may not be possible at all for US residents without explicit Office of Foreign Assets Control approval.

To support the Ukrainian position, the European Union (EU) has introduced sanctions against Crimea, including bans on imports originating from Crimea and Sevastopol, bans on investments in real estate and entities within Crimea, prohibition to provide tourism services in Crimea (including cruise tours to Crimean ports) and supply of goods and technologies to the transport, telecommunications and energy sectors of Crimea. Such sanctions are also extended to any legal person, entity or body in respect of any business done in whole or in part within the EU. In practice, it means EU legal entities and citizens are prohibited from acquiring Crimean real estate if it is used in one of the sanctioned sectors.

Finally, Ukrainian law prohibits the transfer of any assets in Crimea, including real estate, to legal entities that are controlled by the

Russian Federation as the state. Russian state-owned companies and corporations, and those companies where the Russian Government directly or indirectly holds more than 50 per cent of shares, fall under this restriction.

In fact, the circle of persons who are able to more or less legally invest in Crimean real estate is limited to Russian individuals and private companies. But even if there is a potential buyer, one may still experience issues with selling Crimean real estate to Russians.

Place of deal

Ukrainian law provides for real estate sale and purchase agreements to be certified by a notary at the place of location of one of the parties to the transaction or in the location of the real estate. The place of commitment is at the parties' discretion. In the case of Crimean real estate, the deal cannot be executed in Crimea as the Ukrainian notaries had terminated their activity in Crimea. There is no problem if one of the parties to the transaction is a Ukrainian legal entity or individual as the deal may be certified by a notary acting in the place of location of one the parties. But if both parties are non-Ukrainian residents, the Ukrainian notaries have no jurisdiction over those contracts and in fact the contract cannot be certified under Ukrainian law.

At the same time, from the Russian point of view, such a contract can easily be executed in Crimea. Russian law does not require mandatory certification of real estate transactions by the notary. The parties hereto may sign a written agreement and submit it to the real estate register in Crimea for the registration of title transfer. But in this case, a buyer would be registered as the owner in the Russian real estate register, while in the Ukrainian register and in terms of Ukrainian law, the seller would remain the owner as no records have been registered with the Ukrainian real estate register.

The potential Russian buyer might not be concerned about this risk, but there is another issue that cannot be ignored: the buyer would not be able to pay and the seller may not be able to get paid for the Crimean real estate if the transaction took place based on a Russian sale and purchase agreement.

Transfer of funds

First, due to the international sanctions imposed after Russia's annexation of Crimea, US and EU banks have been blocking funds on the correspondent accounts of Russian banks if the details of payments refer to Crimea or Crimean real estate.

Secondly, the bank would debit the seller's account only upon presentation of the contract duly executed under Ukrainian law, that is, certified by a Ukrainian notary. As has been mentioned above, sometimes the execution of such a contract might not be possible.

Finally, the National Bank of Ukraine (NBU) has adopted a decision on the temporary suspension of further activity of Ukrainian bank institutions and their separate sub-divisions in the territory of the ARC and Sevastopol city. Corresponding decisions of the regulator are contained in the Resolution of the NBU Management Board No 260, dated 6 May 2014, which became effective on 6 May 2014.

As a result, the transfer of funds from/to Crimea became impossible.

Hard choice

It looks like legal issues with regard to Crimean real estate will remain unsolved until the status of Crimea has changed. Nevertheless, the deals with Crimean real estate take place on a regular basis. What is the most compliant way of doing a deal in Crimean? Are parallel deals in both jurisdictions in order to comply with both Ukrainian and Russian laws a proper solution? While it looks good on paper, it is not worth believing that this magic solution could solve all the problems and give comfort to the parties hereto. As described above, sometimes it is not even practically possible to do the deal in Ukraine. Even if one succeeds, it creates difficulties as well and demands much care to various details, and it has perils peculiar to complex cross-border deals. We have been advising our clients on a number of Crimean transactions and our experience shows that parties often could not be 100 per cent compliant when dealing with the occupied territory.

Limited options for property investors in the east

As mentioned above, the priorities of investors in property located in the occupied territories in eastern Ukraine are different. While Crimean investors may use the legal tools of Ukraine and the Russian Federation to save

their own investments, an investor owning property in the east faces war risks and the absence of any legal framework established by the government of the state. In such conditions, an investor is interested mainly in the physical preservation of their property or, at least, in the recovery of damages in the case of destruction of the property.

One way of achieving that is insurance. It is unlikely that insurance companies would provide coverage for property located in a war zone, and even if they did, the premium may be very high. And if the property was insured before warfare started, it is possible that insurance companies would raise a defence of force majeure to avoid payments under the policy. In this regard, the insurance of property in regions of eastern Ukraine, which are not controlled by the Ukrainian Government, is not a very attractive way to mitigate losses.

Another option is the recovery of the value of the property that has been destroyed. However, the choice of a defendant for a recovery claim is not so simple. As already stated, some territories in eastern Ukraine are under the control of groups of gunmen, and it is unlikely that suing members of such groups for destruction of property will be successful. At least the enforcement of a judgment against such a defendant may fail because of the absence of assets. Proving guilt in the destruction of property is also a hard task because it may be difficult to prove that a particular person or group destroyed a building using heavy weapons or explosives.

Suing the Ukrainian Government or military forces is not an easier option either. While the claim would be upheld by a court and a judgment may be successfully enforced, the trap is in state policy. The Ukrainian military forces defend Ukrainian sovereignty and territory in the war and there are losses in the war. So, the interest of the state may be higher than the interests of a particular investor and a claim against the government regarding recovery of damages related to loss of property during the war may be rejected because of political motives.

Thus, real estate property investors owning estates in the east of Ukraine are very limited in options for protection of their property. The problem is not a legal problem because the war risks that have recently materialised are not of a legal nature, and they may not be mitigated solely by legal solutions.

Notes

1 Article 11 of the Law of Ukraine 'On Ensuring Rights and Freedoms of Citizens and the Legal Regime on Temporarily Occupied Territory of Ukraine' dated 15 April 2014, No 1207-VII which came into effect on 27 April 2014.

2 According to the Federal Law of Russia 'On state registration of rights to real estate and transactions with it'.

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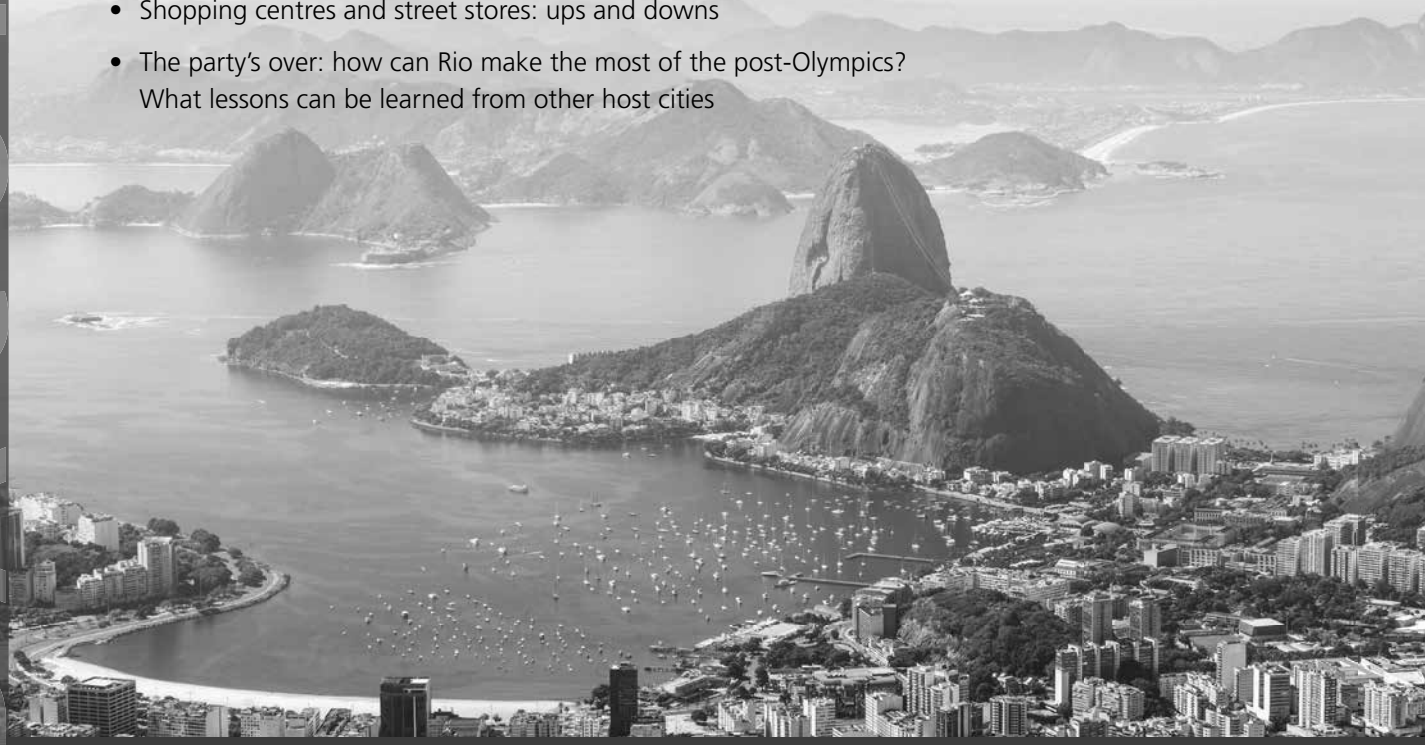

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