Real Estate

Contributing editor
Joseph Philip Forte

2017

GETTING THE DEAL THROUGH

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Getting the Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique **Getting the Deal Through** format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Austria, Mexico, Monaco and Nigeria, plus a revised global overview.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Joseph Philip Forte of Kelley Drye and Warren LLP, for his continued assistance with this volume.

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Global overview

Joseph Philip Forte
Kelley Drye & Warren LLP

Once again the chapters of this book will provide property investors with straightforward legal guidance by each local country counsel concerning the local law and customary practices of various jurisdictions with respect to the acquisition and sale, ownership, development, leasing and financing of property cross-border. But there are also significant economic, financial, political, societal and other issues that may affect an investor's decision whether to make an investment in property outside of its home market. Once again the nature of property as an investment class will require that a prospective investor considers the fundamental risk of not being able to remove or readily transfer its property should a problem arise for its investment.

Endogenous risks

Too much capital, persistent historically low interest rates, overbuilding, excessive leverage or gearing, unsustainable property values and ever-declining capitalisation rates have repeatedly led booming real estate property markets to crash in the past. Yet all of those are unquestionably internal factors that are endogenous to local property and national capital markets. They are the recurring incidents, developments and conditions that occur within property markets that may adversely affect properties in that market. Thus the inevitable boom and bust journey seems to be the natural lifecycle of property markets generally. It is these internal conditions and developments that property experts focus on when researching and assessing where a market is in the cycle. Is the market on the way up or down? Is this the peak or the trough? Is this a time to buy or sell? Or is it time to refinance now or best to wait for interest rates or cap rates to change? Is a particular property type an opportunity to be taken or a growing risk to be avoided? These are the types of questions investors must consider before they commit their capital to an investment in property regardless of whether it is debt or equity. They take the measure of the market from all of the obvious and not so apparent endogenous conditions at play. But which of those factors will be the critical component of the next material disrupter of the particular property market's equilibrium and the initial catalyst for the undetected property market bubble to burst? Historically it is usually too much available competitive capital to, and concentrated overbuilding of a particular property type in, a property market that leads to a downturn. But it is not always the conditions of a particular market that do so. It may be events or developing trends unrelated to the market itself.

Exogenous risks

Property markets can be in equilibrium with strong apparent real estate fundamentals and still be disrupted by known or unknown exogenous events or conditions developing over time. For example, as we noted in our 2016 global overview, geopolitical risk is rarely within the customary scope of property investors' usual property due diligence investigation of the domestic market in their home country, as they are ordinarily fully aware, and albeit unconsciously assess daily, in the market context within which they conduct their property investment strategy and its execution. But with cross-border investment in the acquisition, development and financing of property globally, the panoply of investment risk grows and expands into the unforeseen as well as the unintended consequence of events beyond the control of the market in question. Thus the new normal for property investment – both domestic and cross-border – in the future will be affected for better or worse by exogenous as well as endogenous factors – some seemingly unrelated to property investment or financing markets.

Today local property investment may be disrupted by an ever-expanding host of economic, financial, political and societal events or developing conditions. For example, the continuing fluctuation in the price of oil and other commodities and the attempt to control supply; the deployment of foreign capital worldwide for strategic political purposes; the slowdown of a foreign country's economy and the revaluation of its currency; the stability of cross-border economic zones and the retention of their member countries; foreign government debt or deficits and unfunded future liabilities; state failure and the growth of non-state actors; pressures to tighten country immigration policies and exclude expanding refugee populations; nuclear proliferation; epidemic of cybersecurity breaches in the public and private sectors; money laundering, political corruption and organised crime; foreign-country housing market bubbles collapsing and damaging a country's banking system; international and domestic terrorism; the stability of the foreign country banks and their national financial systems; state capitalism and its enterprises; corporate espionage; water distribution and its scarcity; climate change and resulting catastrophic events; the continued growth of capital outflows for 'safe deposit box-like' investment in foreign property; the rise of nationalism and isolationism; threatened retreat of globalisation of markets; unintended consequences governments' monetary policy; and national as well as international financial regulation.

Obviously the foregoing are just a few of the global events, recurring issues and developing trends that we know about that investors may consider as potential exogenous disrupters whose unintended consequences may well affect their decisions about their allocation and deployment of capital for property investment at home and abroad. So who or what will be the next exogenous agent or cause of market disruption in property investment? While past performance is no guarantee of future results, the key indicators of disruption for the property markets going forward will be the excessive growth of governmental regulation of financial institutions and the changes wrought by developing technology and differing generational demographics.

First disrupter

In the wake of the most recent financial crisis, which very nearly resulted in the complete meltdown of the global financial system, national as well as international financial regulators decided to reform the entire system by attempting to eliminate risk as well as bank failures by prohibiting or at least circumscribing certain investment activities, increasing risk-based capital retention to provide a greater cushion against potential losses in a market downturn and by generally imposing a comprehensive international system of financial regulation. One immediate result of their regulatory spree has been the exponential growth in internal regulatory compliance personnel at financial institutions burdening the regulated institutions with significant added expense and time spent in understanding and complying with thousands of pages of new regulatory schemes deemed necessary by the regulatory authorities to avoid market practices that were believed to have destabilised the global financial markets in 2008. In the US, the Dodd-Frank Act of 2010 mandated a variety of restrictions on the structuring, sale and disposition of interests in asset securitisations with

the intent of avoiding an 'originate and distribute' business model by requiring issuers in securitisations to retain some credit risk ('skin in the game') in the form of a 5 per cent interest that cannot be transferred for a specified hold period, financed or hedged. In commercial mortgage-backed securities (CMBS) only, however, an issuer is permitted to satisfy all or part of its mandated risk retention through one or two pari passu holders of the first loss position (the 'B-piece buyer') in the CMBS capital structure. Internationally, in 2010 the Basel Committee on Banking Supervision promulgated the third of its Capital Accords (Basel III), which has enormous implications for banks by making significant changes to property lending and the related risk-based capital rules. As adopted by federal banking regulators in the US, it is focused on acquisition, development and construction lending by requiring 150 per cent capital risk weighting after 1 January 2015 until it is replaced by a 'permanent' loan, unless the loan is exempt by meeting several very market- and borrower-unfriendly conditions. The rule clearly demonstrates regulators' serious lack of understanding of the basic mechanics of construction financing and the established market risk mitigation construct used by sophisticated lenders in making such loans. While the high-volatility commercial real estate rules have been in effect for nearly two years and their negative consequences are already affecting the banking sector's appetite for construction loans, the full impact of risk retention on CMBS as a viable exit strategy will not be fully apparent in the property finance market until well after its Christmas Eve 2016 effective date. And while a potentially 'risk retention'-compliant securitisation has been issued and others planned, the question is whether there are investors willing to use, or have the available capital for, the proposed alternative 'compliant' securitisation structures.

Interestingly, during the 2016 G20 meeting in China, serious concern was expressed about the growing regulatory regime and its unintended consequences, sacrificing economic growth in the quest to eliminate risks by an overreaching regulatory regime. Recently, the Governor of the Bank of England recognised publicly that some proposed banking regulations may actually threaten operational stability. Nevertheless, these concerns have not reached the US bank regulators, who continue to issue new banking regulations without regard to their impact on liquidity and volatility. A seismic shift is occurring as a result of this new regulatory environment, but we will not know or appreciate how the banking industry has fundamentally changed or what part of its original business has migrated over to, and been assumed by, private equity funds and specialist lenders in the unregulated shadow banking industry, who for now are beyond the reach of the banking authorities and their rules.

Second disrupter

While property research for developers, owners, landlords, retailers, hotels and others has been principally focused on the impact that the millennial cohort of the population (Generation X and Generation Y) will have on the planned development and use of commercial and residential property as the baby boomer and echo boomer cohorts decline as a proportion of the populations of workers, shoppers, renters, homeowners and travellers around the world, the results of that research and the adjustments made in property development and planning, as well as business plans tailored to meet millennial preferences and avoid their dislikes, may not be fully accounting for the long term as they are ignoring the cohort right behind the millennials. They are no older than 20. Born after the mid-1990s they are known as Generation Z (or centennials or iGen). Specifically, unlike millennials who were around before the smartphone, Generation Z was born into the world where the smartphone was already ubiquitous. Smartphones have always been part of their lives and they use them for everything they need. The Center for Generational Kinetics in Austin, Texas, which specialises in generational research, has released a study entitled *iGen Tech Disruption* that makes it very clear that Generation Z and its preferences, dislikes and general approach to work and life in general are much different from the millennials. Thus property professionals looking to see what and how they need to adjust their development and planning for the future will need to have a two-prong approach to encompass both Generation Z and millennials. Failure to do so may be costly, as Generation Z is quickly approaching entering the workplace, the shopping mall, a rental apartment and life in general on their own but alongside millennials. Be prepared for faster change than from boomer to millennial.

Conclusion

Identifying and assessing risk has and will always be a crucial part of investing in property and its financing – whether patent or latent, endogenous or exogenous. Investors must always investigate and evaluate the identified risks for a property investment as to their magnitude, probability and consequences (direct or indirect). If the investor decides not to avoid the risk but embrace it, then it must determine how to best minimise, mitigate or, if possible, eliminate the risk to the property investment. How the property investment or financing risk is approached and invested into depends on several factors: who is investing; where they are investing; what they are investing in; how they are investing; and finally, but most importantly, why they are investing. Today regulatory and demographic risk management as part of an investor's strategy is more often an executive suite discussion and decision rather than a traditional compliance analyst's modelling and checklist completion.

Austria

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General

1 Legal system

How would you explain your jurisdiction's legal system to an investor?

Austria has a civil law system. Private law is primarily governed by the Austrian Civil Code (ABGB), which codifies the basic principles of private law such as transfer of ownership, forms of representation or liability. Besides the ABGB, there are more specialised laws, such as the Act on Tenancy Law (MRG), the Consumer Protection Law (KschG) or the Austrian Commercial Code (UGB).

Judicial precedent law is not absolutely binding in Austria. The principle of legal certainty requires, however, that identical cases are decided identically. Case law is not considered an official legal source in Austria, but in general courts tend to follow the prevailing precedents of the Austrian Supreme Court.

In principle, oral contracts are enforceable. Most rights relating to real property (eg, ownership), however, can be acquired only upon execution of a written deed and its registration in the Land Register.

The Austrian legal system allows for several forms of injunctions to warrant temporary legal protection.

2 Land records

Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

Austrian real property law is based on the registration principle (ie, real property is registered in the Land Register). Rights with respect to real estate, such as ownership and mortgages, are recorded in the land title register. Subject to certain exemptions, ownership and other property rights can be acquired only by registration in the Land Register. To obtain ownership of real property, an obligation, such as a purchase agreement, and an act of disposal, which is the entry in the Land Register, are required. Title transfer deeds are deposited at the Land Register. Therefore parties often conclude two contracts for one transaction: a small contract governing the title transfer, which is deposited in the Land Register, and a more comprehensive contract, which governs all the details of the transaction.

The Land Register is available online and can be accessed by everyone upon a small charge. Generally, the 'trust principle' applies to entries in the Land Register. The facts registered in the Land Register are deemed to be correct. As a result, entries in the Land Register are to be regarded as valid, whereas non-existent entries are seen as without consequence for a real property. This means that the bona fide purchaser still acquires ownership of a real property even if the seller is wrongfully entered in the Land Register as the owner, providing that the legal transaction involved valuable consideration. If circumstances exist that on proper notice give rise to doubts as to the correctness of the Land Register status, the purchaser is under an obligation to carry out an examination; failure to do so invalidates the good faith. If the suspicion thus arises that the actual legal situation in the Land Register is not depicted correctly, it is not possible to apply the trust principle.

Mortgages have to be registered in the Land Register to become effective. A lease is a consensual contract (ie, no registration in the Land Register is required). Registration of the lease contract is nevertheless possible.

3 Registration and recording

What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

To constitute property rights on real estate an application must be filed with the competent Land Register court. The application does not have to be filed by a lawyer, although it is highly recommended to take legal advice owing to the strict formal requirements of the Land Register legislation. In addition to that application several documents are required, eg, the purchase agreement with the signatures of all contracting parties certified by either a court or notary.

While EU citizens generally enjoy equal rights as residents, mandatory approval is required if third-country citizens purchase a right to a property or an apartment. However, all nine Austrian provinces have established different regulations under which the acquisition of real estate and certain rights with respect to real estate is subject to the approval of land transfer authorities and the restrictions imposed vary from province to province and mainly depend on how the real estate is zoned.

The application fee is €42, rising to €59 if not paid electronically. Additionally 1.1 per cent of the property value (which usually equals the purchase price) has to be paid to register the new ownership in the Land Register. If the purchase is financed via a loan an additional fee amounting to 1.2 per cent of the total mortgage is required for entering the mortgage in the Land Register along with the property.

Real estate transfer tax amounts to 3.5 per cent (in principle, there are certain exemptions) of the property value/purchase price. Although both the seller and the purchaser are liable for the payment of the tax, it is common practice that this tax is paid by the purchaser. Often, the factual payment of the tax is done by an escrow agent involved in the transaction.

A registration in the Land Register (including the corresponding fees) can be avoided if the transaction is structured as share deal. However, for acquisitions from 1 January 2016 onwards, the transfer/unification of at least 95 per cent of the shares in a company holding Austrian real estate is a taxable transaction triggering 0.5 per cent real estate transfer tax from the land value.

4 Foreign owners and tenants

What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

Mandatory approval is required if third-country citizens (ie, non-EU citizens) intend to acquire a right to a property or an apartment. The provinces have jurisdiction in a matter of legislation and enforcement over that field. Hence all nine Austrian provinces have established regulations under which the acquisition of real estate and certain rights with respect to real estate (by foreigners (in some cases also by Austrians) is subject to the approval of land transfer authorities.

The responsible authorities are either the provincial authority or the district administration authority, depending on where the property

is located. The documents required include: request of approval, contract or draft contract, declaration on the use of the property, surveyor's plan, up-to-date abstract from the Land Register and passport. Differences exist between the individual federal provinces with regard to the depth of the investigation into the indirect participations of foreign nationals. If the purchaser is a legal entity a current extract from the company register, the company deed and a trade licence are further required. If the purchaser is an association an extract from the register of associations and the association statutes as well as proof of citizenship for the members of the association board have to be filed. In addition to that, proof of income has to be shown upon request by the respective authority. Fees can differ from province to province.

5 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

After payment of all taxes, foreign investors are free to repatriate profits from Austria. There are no exchange control limitations with respect to real property. Apart from certain embargo provisions aimed at combatting money laundering and terrorism, all domestic and foreign investors are treated equally.

6 Legal liability

What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

Austria's civil law system knows two types of liabilities: claims based on a breach of contract and claims based on tort. In both cases, the injuring party owes the injured party compensation for the endured damage but no punitive damages. As a principle, only unlawful behaviour constitutes liability. However, a strict liability applies in certain cases.

A special liability is, for example, set forth in section 1319 ABGB, pursuant to which the owner of a building (a term which is broadly interpreted by Austrian courts) is liable for damage caused by a collapse of the building or parts thereof coming off (eg, falling roof tiles). Contrary to the general principles of Austrian tort law, in these cases the owner of the building has to prove that he or she has done everything (acting reasonably) to avert danger (reversed onus of proof).

If a real estate is contaminated, authorities might require the landowner to remediate the contaminated land. In this case, the landowner might have warranty or tort claims against the seller of the real estate or the person responsible to the contamination (respective warranty provisions are common practice in real estate purchase agreements).

7 Protection against liability

How can owners protect themselves from liability and what types of insurance can they obtain?

Private liability can be avoided by incorporating an Austrian legal entity with limited liability such as GmbH or AG. Furthermore, it is recommended to take out various insurance policies to minimise the investor's risk (eg, building insurance or environmental liability insurance). Regarding environmental risks, a register of contaminated sites is available online at www.umweltbundesamt.at/umwelt/altlasten/vfka/. Since not all contaminations are listed, this register does not provide sufficient protection, however.

Legal, tax and technical due diligence and properly drafted transaction documentation may also reduce the purchaser's risk.

8 Choice of law

How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

Parties to a transaction may choose any governing law. However, rights to Austrian real property, including the form of contracts related to real property, must be governed by Austrian law. Ancillary provisions of the contract may be governed by any law.

9 Jurisdiction

Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

Austrian civil courts have exclusive jurisdiction over in rem rights relating to Austrian real property.

District courts have jurisdiction over conflicts concerning rental or leasing contracts. In some municipalities, a claimant may also appeal to one of the regional mediation bodies before filing a claim. The mediation bodies are free of charge and their decision is binding if none of the parties appeals to the district court within four weeks.

Disputes concerning the purchase of real estate belong to the regional courts. Commercial courts have jurisdiction over commercial matters (eg, conflicts concerning the purchase of a company). Parties may also opt for the competence of an arbitral committee.

Austrian law acknowledges the legal capacity of foreign persons. Accordingly, it is possible for foreigners to file a claim and enforce remedies. However, courts may require an Austrian address for service and impose a security deposit from foreign plaintiffs.

10 Commercial versus residential property

How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

Austrian tenancy law is governed on the one hand by the ABGB and on the other hand by the MRG and three categories of lease agreements can be distinguished, namely lease agreements that are subject to the MRG in their entirety ('full scope'), lease agreements that are only subject to the MRG in part ('partial scope') and lease agreements that are not subject to the MRG (lease agreements of this kind are exclusively subject to the ABGB). Simplified lease contracts for rented apartments in a building constructed before 1 July 1953 and rented freehold apartments in a building constructed before 9 May 1945 have the strictest regulation (full scope), for example, the rental fee is regulated and the landlord must not terminate the lease contract for no reason. The MRG stipulates detailed requirements in respect of the basic feature of lease agreements, in particular with regard to rent calculation, operational costs, maintenance, term of agreement and notice of termination, and protection against eviction and any contractual deviation may only be effected in favour of the tenant. Most other lease contracts, including contracts on commercial properties, are only partly regulated (partial scope) – most notably, the landlord's right to terminate the lease contract is limited. Lease contracts on holiday flats, apartments located in a building that does not comprise more than two rental objects and some other exceptional cases are least regulated.

11 Planning and land use

How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

Construction has to be in accordance with zoning and development plans. Access to these documents is granted at municipal offices. In addition to this, building permits are required. Every province in Austria has its own building code. The municipality's mayor is in general the competent authority for granting these permissions. Usually, construction negotiations are scheduled in which, among others, neighbours can raise objections if they believe their subjective public rights are violated (eg, regarding the distance of the construction from the neighbour's property). Preservation orders can constitute a further restriction to planned construction in Austria.

12 Government appropriation of real estate

Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

Legal instruments of expropriation exist in Austria; however, they are subject to strict requirements, as property itself is protected by the constitution. Foreigners can rely on this right as well. Expropriation is permitted only if it serves the public interest. Therefore specific need, suitability of the object to cover that need and impossibility of any other measures are mandatory. In addition, expropriation has to comply with the principle of proportionality. Further details are governed by laws on expropriations in specific cases (eg, for railway construction). Usually the owner of the real estate is granted adequate (rather low) compensation. In practice, mutual agreements between the state and the landowner are common.

13 Forfeiture

Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

The Austria Criminal Code provides measures to forfeit real estate property. A criminal court can seize property in order to prevent an illegal activity from happening. Furthermore the Austrian law provides the option for the Criminal Court to forfeit assets gained by criminal acts.

14 Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency system in your jurisdiction.

The Insolvency Code contains provisions for bankruptcy proceedings as well as reorganisation proceedings, the latter being either conducted with a liquidator or with self-administration. Illiquidity and over-indebtedness are the main legal requirements to initiate an insolvency procedure. The motion can be prepared by either the debtor itself or its creditors. Under certain circumstances a delayed insolvency application is seen as a criminal offence entailing severe punishment for the debtor. The opening of the proceedings will be published by the court and the debtor loses its power of disposition. Thenceforward the debtor cannot make any payments with debt-discharging effect. During the insolvency procedure creditors are treated differently, depending on their state of their claims, for example, mortgage creditors enjoy a privileged position compared with subordinate creditors.

Investment vehicles

15 Investment entities

What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

Austrian commercial law recognises following legal entities, which are also open to foreigners:

- general partnership (OG): full liability of shareholders, not the partnership, but the shareholders pay income tax;
- limited partnership (KG): similar to the OG, but (at least) one shareholder has only limited liability;
- private limited company (GmbH): limited liability of shareholders, minimum share capital of €35,000;
- corporation (AG): limited liability of shareholders, minimum share capital of €75,000, can be a joint-stock company;
- less commonly used forms include the Societas Europaea (SE), the silent partnership or the cooperative; and
- forms from other EU member states can also exist in Austria (eg, the Irish limited company).

16 Foreign investors

What forms of entity do foreign investors customarily use in your jurisdiction?

In general foreign investors prefer private limited companies mainly for two reasons: limited liability for the investors as corporate assets are separate from personal and low formality compared with the joint-stock company, where, for example, a supervisory board is compulsory. In real estate, special purpose vehicles often take the form of a 'GmbH & Co OG' or a 'GmbH & Co KG'. Both are partnerships, in which the partners who have unlimited liability are private limited companies. Accordingly, these forms combine the flexibility of partnerships with limited liability.

17 Organisational formalities

What are the organisational formalities for creating the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

Registration with the Commercial Register is a mandatory requirement for creating the above-mentioned entities. In addition, a partnership agreement is required for capital companies in the form of a notarial deed. Private limited and joint-stock companies can be established by a single founder. Minimum registered capital for a private limited company is €35,000 (possibility to make use of founder privilege, which reduces the required capital to €10,000 in the beginning) and €70,000 for joint-stock companies. At least half of this amount has to be paid into the bank account of the company.

The corporation tax for private limited and joint-stock companies is 25 per cent, while capital gains tax has been 27.5 per cent since the beginning of 2016. That results in a tax load of 45.625 per cent. Compared with that, partners of general partnerships and the general partner of a limited partnership are taxed on a personal level. Austria's taxation system is subject to progressive rates, the top taxation rate is 55 per cent (which will be reduced to 50 per cent in 2020).

There are no special taxes imposed on foreign entities. Individuals planning to reside in and conduct business in Austria, except for EU nationals, need a residency permit.

Acquisitions and leases

18 Ownership and occupancy

Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

Austrian law recognises freehold as permanent unrestricted ownership and leasehold as tenancy for a definite or indefinite period of time, which may involve a right to derive profit from leased property.

Austrian property law recognises the principle of 'superficies solo credit': the owner of a plot of land is automatically the owner of the buildings erected on it. This principle of the inseparability of land and building ownership is overruled by two exceptions, namely the existence of a superstructure (building on third-party land) and the building right. A superstructure is a building on third-party-land, built without the intention to remain infinitely. It is popular owing to tax-related aspects, but rarely used as collateral, among other things because it is not registered in the Land Register. The building right is the right to build on foreign land owing to a contract between the landlord and the owner of the building. After a stipulated period of time, the landlord becomes owner of the building.

Austrian legislation recognises two types of easements: easement in rem and in personam. The former benefits all owners of a particular real property to which an easement is created and survives transfer of such real property. The latter is created solely for the benefit of a particular person.

19 Pre-contract

Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

There are two forms of binding pre-contracts mentioned in the ABGB: a *Vorvertrag* (article 936 ABGB) is a binding contract that enables a party to sue the other party for entering into the main agreement; a *Punktation* (article 885 ABGB) is a contract that already includes the main rights and duties the parties wish to create. If the parties fail to enter into a (more detailed) main contract, the rights and duties included in the *Punktation* become enforceable.

Practice, however, has invented several new types of contract, not provided by statutory law. Especially in larger transactions and when a due diligence will be conducted, letters of intent are commonly used. Depending on their content, they can be either binding or non-binding, but typically the Austrian High Court considers them as non-binding. Parties can agree upon a contractual penalty, but the unreasonable break-up fees may be reduced by the court.

20 Contract of sale

What are typical provisions in a contract of sale?

The sale contract must be agreed in writing and includes, at the least, a description of the transferred property (property type, cadastral area and plot identification number) and the price (or the price calculation method). Representations and warranties are not mandatory but highly advisable. Typically, the seller gives at least representations and warranties regarding ownership, third-party claims, encumbrances and compliance with relevant building regulations. It is common practice to also include a provision containing the specification of the property and the seller's express consent to the registration of the purchaser as new owner of the property. Often, real estate transactions include escrow payment mechanisms, which can be conducted by the advising lawyer.

21 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

Liability in the case of contaminated properties is regulated by several acts, the most important ones being the Water Rights Act (WRG) and the Waste Management Act (AWG). Both acts stipulate a primary responsibility of the actual polluter and a subsidiary responsibility of the property owner.

The subsidiary liability of the property owner passes to the legal successors if the contamination was known or should have been known to the acquirer in case of reasonable care. Both the WRG and the AWG nonetheless limit the liability of the property owner to contaminations that occurred before 1 July 1990, unless the owner explicitly allowed the respective contamination and has benefited in the form of consideration for the use of his property.

Contaminations may entitle the purchaser to claim damages from the seller. The Austrian High Court, however, has ruled in several decisions that the purchaser of a former industrial site must expect certain contaminations and thus cannot claim damages for 'average' contaminations. To prevent disputes on what kind of contaminations were to be expected, it is highly advisable to include respective warranty provisions in the sales contract.

22 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

With respect to existing leases, sellers usually grant representations concerning the rent roll, the validity and enforceability of existing lease agreements, the existence of all agreed cash deposits or bank guarantees, the non-existence of any defaults under the lease agreements, the non-existence of any pending or threatened terminations, the non-existence of (pending or threatened) litigation regarding the lease agreements, the compliance with tenant improvements, the correctness of past invoices for incidental costs and the payment of all stamp duties. Between signing and closing, sellers usually covenant not to execute new leases or amend or terminate existing leases without the buyer's consent or not to carry out any unforeseen tenant improvements or other major investments without the buyer's consent.

Brokerage agreements are separate from lease agreements and are not transferred together with the property unless the parties agree otherwise.

Estoppel certificates from tenants are not common or required as a condition to the obligation of the buyer to close under a contract of sale.

23 Leases and real estate security instruments

Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

A lease is not subordinate to a security instrument. When a debtor fails to repay the debt and the debtor's property, which includes leases, is sold, the new owner becomes the landlord. As a fundamental rule, the Austrian legislature provides that the purchaser of a property has to take over existing tenancy relationships (article 1120 ABGB). This applies even if the purchaser had no knowledge of the existence of the lease agreement. He or she enters into the existing tenancy relationship with all rights and obligations. However, both the purchaser and the tenant cease to be bound by fixed terms or agreed waivers of termination. Thus they are both entitled to terminate the tenancy adhering to the statutory period of notice. Exceptions to this fundamental rule exist when the tenancy relationship was registered in the Land Register (the landlord is bound by the term of the tenancy relationship as entered in the Land Register), in cases where the full scope of the Austrian Tenancy Act applies (see question 10) or if the tenancy agreement contains a deviant provision.

24 Delivery of security deposits

What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

Security deposits are commonly used to secure future claims against the tenant. There are no statutory regulations with respect to the permitted amount of such deposits. Court rulings suggest an amount of not more than six months' gross rent as the upper limit; three months is a common limit.

If the security is provided in cash, the landlord is obliged to put the money in a savings account and return it to the tenant immediately after the contract has expired including the interest earned. Often, the deposit is not provided in cash, but in the form of a bank guarantee. We recommend potential purchasers to examine whether existing bank guarantees are assignable to a new owner (if not, the tenant should be

contractually obliged to issue a new bank guarantee in favour of the new owner).

The majority of tenancy agreements are subject to indexation. Within the full scope of the Austrian Tenancy Act (see question 10), statutory law stipulates precise rules for the value adjustment, which can only be linked to the consumer price index published by Statistics Austria. If the full scope of the Tenancy Act does not apply, parties are free to decide upon the type, scope and quality of the indexation clause. Threshold clauses with a 3 to 5 per cent threshold are customary. In any event, the indexation clause must be explicitly agreed.

25 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain a zoning report or legal opinion regarding legal use and occupancy?

Facts registered in the Land Register are deemed to be correct. Thus a purchaser with good faith acquires ownership of real estate, even if the seller is wrongfully registered as the owner in the Land Register. If circumstances exist that on proper notice lead to doubts as to the correctness of the Land Register, the purchaser has to carry out an examination on the ownership of the real estate. Failure to do so invalidates the good faith.

The rank of priority of securities is defined by the order of their registration in the Land Register (previously registered securities having a higher rank and priority if the security is realised).

Zoning reports are generally available online and can be reviewed with very little time and effort. Legal opinions are a possible instrument in Austrian law but not customarily used with regard to the legal use and occupancy of real estate.

26 Structural and environmental reviews

Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

Regarding environmental risks, it is recommended to review the register of contaminated sites available online at www.umweltbundesamt.at /umwelt/altlasten/vfka/. Since not all contaminations are listed, this register does not provide sufficient protection, however.

Engineering and environmental reviews are advisable, especially in large transactions or in transactions where difficulties in this regard are to be expected (eg, the purchase of a former industrial site). Standard representations regarding the technical condition of the transferred buildings as well as representations and indemnities regarding environmental matters are customary. Environmental liability insurance is available.

27 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

Lease agreements are usually reviewed by lawyers and tax consultants; the business side is often covered by the investor itself. The legal analysis is based among other things on an examination of the scope of the Austrian Tenancy Act (see question 10), the right to rent increases and change of control clauses, rent indexation, lease termination clauses, payment of stamp duties and maintenance obligations by the landlord. Whether property and facility management agreements are transferred to the new owner depends on the structure of the deal (asset or share deal) and possible change of control clauses in the respective agreements.

28 Other agreements

What other agreements does a lawyer customarily review?

- Agreements establishing pre-emption rights;
- mortgage and other financing agreements;
- easement agreements authorising a specific person (easement in personam) or an owner of a particular real property (easement in rem) to use the land (eg, a right to pass through the land);
- easement agreements;
- utility supply agreements;
- property insurance agreements;
- articles of association and other corporate documents in the case of a share deal; and
- brokerage agreements.

29 Closing preparations

How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

Lawyers usually prepare a detailed closing checklist to verify whether all closing conditions and deliverables have been met. Typically, lawyers check whether all required corporate certificates, extracts from the Commercial Register and deeds of ownership have been presented, whether all existing mortgages and other charges have been properly released and whether all the relevant agreements and project and design documentation have been delivered. Proration of costs and revenues from the property as of the closing date is also customary.

In an asset deal, signing and closing usually happen at the same time.

30 Closing formalities

Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

The parties' signatures on the purchase agreement must be verified by a notary public. Also mortgage deed signatures are to be notarised. Except of this, no government representative is required.

31 Contract breach

What are the remedies for breach of a contract to sell or finance real estate?

Usually the parties to a purchase agreement or finance agreement stipulate the remedies for a breach of contract and do not rely on statutory law in this regard. Usually a breach of contract entitles the injured party to terminate the contract or request compensation for damage (payment of a contractual penalty is a possible consequence as well, but less frequently used in this regard). Often, different remedies are set forth for different types and severity of breaches.

32 Breach of lease terms

What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply?

Depending on its type and gravity, a breach of lease terms may entitle the injured party to claim damages, termination of the lease contract or both (even if the contract is non-redeemable); the tenant may also be entitled to pay less rent until the breach is cured. Additionally, a landlord has statutory retention and pledge rights over tenants' assets located in the leased premises to secure claims for unpaid rent. Tenants using premises after the termination of the lease may be evicted through customary judicial proceedings.

Financing

33 Secured lending

Discuss the types of real estate security instruments available to lenders in your jurisdiction.

Lenders usually require a mortgage on the financed real estate. Such mortgage is established through (notarised) signature of a mortgage deed and registration of the mortgage in the Land Register. Different types of mortgages exist: a fixed-amount mortgage secures

Update and trends

Figures for the first half of 2016 show that both the number of transactions and prices for real estate are growing considerably. Because of low interest rates, we expect this trend to continue. Additionally, demographic trends are leading to an increasing demand for living space. The enhancement in construction activities is further boosted by a government initiative to support the building of living space that started at the beginning of 2016.

a numerically defined liability (plus ancillary charges and interest for up to three years), while a maximum-amount mortgage secures all receivables under a contractual relationship up to a maximum amount.

In addition to that, lenders often require pledging or assignment for securities of shares, receivables, rights under property purchase agreements, bank accounts and insurance certificates.

34 Leasehold financing

Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

In Austrian law, it is possible but very uncommon to finance ground or head leases, and according to our experience it might be very difficult to find a bank doing this kind of financing.

35 Form of security

What is the method of creating and perfecting a security interest in real estate?

A mortgage is established through signature of a mortgage deed and registration of the mortgage in the Land Register by filing the deed with the documents archive. The signature on the mortgage deed has to be notarised.

In some financings, already registered mortgages are taken over by the financing party. A registered mortgage is not automatically cancelled with the repayment of the secured debt; thus 'debtless' mortgages may arise, of which the owner can dispose. However, the entry of a new creditor for the already registered mortgage would trigger the same costs as a new mortgage entry. Thus, in order to avoid costs, taking over existing mortgages is usually done by taking over the secured obligation only. The old creditor remains creditor in relation to the debtor (and remains registered in the Land Register), but he or she undertakes to hold debt and mortgage in trust for the new creditor. The credit risk is borne by the new creditor.

36 Valuation

Are third-party real estate appraisals required by lenders for their underwriting of loans? Must appraisers have specific qualifications?

Banks usually require real property valuations for granting a loan. Valuations are prepared either by in-house valuation departments of the banks or third-party professionals, who may, but need not, be registered with the relevant state authorities.

37 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

Lenders from another jurisdiction can provide loans secured by Austrian real property collateral under the same conditions and ramifications as Austrian lenders. This is, of course, subject to any banking or financial services regulations that may be applicable.

38 Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

Interest rates are usually set with reference to EuriBOR; references to LIBOR are possible, but usually avoided.

If the interest rate is very high, the loan agreement might be considered as contra bonos mores and thus be void. If the financing party exploits the improvidence, dilemma situation, lack of intellectual power, inexperience or disconcertion of the other party to stipulate an unreasonably high interest rate, the contract is void in any case. However, it is difficult to examine what interest is still legally impermissible. Court decisions on this question do not name a fixed maximum rate, but explain that the maximum rate depends on the circumstances of the financing (eg, the securities available), the other terms of the contract (eg, the duration of the loan) and the market situation.

39 Loan default and enforcement

How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

Secured creditors can enforce a mortgage or pledge when the underlying secured claim is not duly and timely paid. To realise the mortgage, an execution title from the district court is required, while non-judicial realisation is available for pledges on moveables.

40 Loan deficiency claims

Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

If the amount recovered in the foreclosure is less than the outstanding loan balance, the deficiency between both amounts is still outstanding and accordingly has to be paid by the lender. This obligation by the lender is similar to any other obligation.

41 Protection of collateral

What actions can a lender take to protect its collateral until it has possession of the property?

In Austrian law, the establishment of a pledge requires not only a pledge agreement but also the performance of the required act of publicity, which grants the lender possession or similar protection. The following acts of publicity are most commonly used:

- book entry if the receivables are recorded in the pledgor's books;
- notification of third-party debtors (eg, tenants); and
- handover in the case of corporeal property.

42 Recourse

May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

Security documents may only provide recourse to specified assets (ie, it is not possible to grant a pledge over 'all assets').

43 Cash management and reserves

Is it typical to require a cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

Lenders usually require that all cash traffic of the borrower is directed through bank accounts opened with that lender. Similarly, lenders often demand lock-box mechanisms linked to specific financial covenants or other triggers.

44 Credit enhancements

What other types of credit enhancements are common? What about forms of guarantee?

Several different types of credit enhancements are common in Austria (eg, personal securities, cumulative assumption of debts or comfort letters).

45 Loan covenants

What covenants are commonly required by the lender in loan documents?

Loan agreements contain all kinds of covenants, depending mostly on the target and the conducted due diligence, similar to most other central European countries.

46 Financial covenants

What are typical financial covenants required by lenders?

Financial covenants usually do not differ from those used in most other central European countries.

47 Secured moveable (personal) property

What are the requirements for creation and perfection of a security interest in moveable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

See question 41.

48 Single purpose entity (SPE)

Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

SPEs are commonly used in real estate transactions. With respect to possible forms, see questions 15 and 16. The managing director of an SPE can be managing director of the parent company at the same time.

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General

1 Legal system

How would you explain your jurisdiction's legal system to an investor?

Brazil is a civil law jurisdiction, meaning that codes and statutory law are the primary source of law, as opposed to a common law system in which judicial precedents are the most relevant source of law. In Brazil precedent from higher courts is generally not binding (the concept of stare decisis does not apply), but it guides decisions from lower courts. There has been a tendency to give greater importance to precedent.

There are three levels of laws: federal, state and local. There are also administrative rules issued by federal, state and local entities.

Oral contracts are valid if the law does not requires a specific format; however, the evidentiary mechanisms are more complex. When referring to real estate contracts there are specific requirements to be followed; for instance, contracts aimed at creating, transferring, modifying or waiving in rem rights concerning real estate with a value above 30 minimum national wages need to be executed under a public deed in the presence of a notary, except if otherwise provided for by law.

The right of action is a constitutional right for every Brazilian citizen. Any laws or court decisions preventing parties from obtaining any relief or accessing the judicial system are unconstitutional. Generally, ruling in equity is forbidden. The Brazilian Code of Civil Procedure only authorises ruling in equity in express cases established by law, such as in arbitration proceedings, in which the parties can, before the commencement of the proceeding, agree upon decision based on equity.

Parol evidence is not the general rule under Brazilian law. Even when parties have not made all their understandings in writing in a certain agreement, external elements, such as emails, oral understandings and practices that do not comprise the written form of the agreement may be used as a basis for interpretation.

2 Land records

Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

The Brazilian system for real estate interests is based on the recording of title (deed of purchase and sale, mortgage, leases, easements, etc) at the competent real estate office. The absence of recording does not affect the assumption of obligations and rights between the parties, but these rights and obligations become effective before third parties only upon the recording of the title. In this sense, whoever records its respective title first has priority interest before any other titles regardless of their date of execution, guaranteeing priority and the right itself if there are contradictory instruments related to a same real estate. Depending on the nature of the deal, title registration is mandatory, which means that the title must be executed in the presence of a notary and under a public deed. Other titles have the facility to be executed in a private form. Both can be recorded. The recording takes place at the real estate registry where the specific real property is located.

3 Registration and recording

What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

The Federal Public Registry Law mainly rules the recording of title regarding real estate. As general rule, in order to be recorded, contracts relating to real property must be executed in the presence of a notary. There are exceptions, such as lease agreements, fiduciary transfer of collateral and contracts that involve properties valued at less than 30 minimum wages. In these cases, the respective agreement may take the private form instead of the public one (drawn up by a notary). The basic requirement for the recording of title is the proper qualification of the parties involved, their powers and necessary authorisations, and the precise identification of the real property (indication of enrolment, description of the property and acquisition title). The costs for registering and recording are defined by state laws and take into consideration the amount of the agreement up to a maximum amount. Federal, state and municipal real estate taxes apply to the transfer or assignment of ownership rights, and are usually paid by the buyer, but may be agreed otherwise.

4 Foreign owners and tenants

What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

The basic requirement for the acquisition of real property is the obtaining of a taxpayer enrolment before the Brazilian Federal Revenue (CNPJ for legal entities and CPF for individuals). The acquisition of rural real property by foreign individuals residing in Brazil and foreign legal entities authorised to operate in Brazil, or Brazilian entities controlled by foreigners, relies on compliance with specific restrictions provided for in federal legislation, specially an authorisation from the Ministry of Agriculture linked to the activities to be developed on the land. The restrictions also depend on the size of the rural real property. There is a bill of law in progress aiming at reducing the restrictions applicable to Brazilian entities controlled by foreigners. Brazilian law also requires specific authorisation from the National Security Council for the acquisition by foreigners of real property in Brazilian border areas (the zone within 150 kilometres of the country's borders). Financial institutions are released from such authorisation when obtaining collateral over bordering rural real property or receiving bordering rural real property in payment of loans. Any acquisition of rural real property by foreigners or Brazilian entities controlled by foreigners is required to be executed before a notary under a public deed.

5 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

According to the tax rules in force, there are no exchange control issues involving non-resident investors in Brazil. As a rule, foreign investor are treated as Brazilian individual for tax purposes. However, in the case where an investor wants to repatriate profits to its jurisdiction,

exceptionally the tax treatment may vary depending on the type of structure adopted.

6 Legal liability

What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

Upon acquisition, the buyer becomes liable for all events that occur on the acquired real estate, from a civil (eg, accidents), tax, environmental and administrative standpoint. The buyer also becomes liable for some specific circumstances that might have occurred before the acquisition, known as propter rem obligations (eg, pending property taxes, environmental liabilities and condominium expenses). It means that the competent authority will claim from the owner, who is entitled to claim back from the seller. The tenant, on the other hand, will assume liabilities related to the period of possession over the real estate. Since a lender does not normally take possession of the real estate until forfeiture of its guarantee, the guarantor remains responsible during the term of the guarantee.

Regarding environmental liability, the Brazilian legal framework widens the concept of polluter to deem liable for repairing environmental damage any person or legal entity whose activity has directly or indirectly contributed to the chain of causation that led to the damage. It specifically deems the owner or tenant of real estate jointly and strictly liable for repairing any environmental damage in connection with the property, including soil and groundwater, regardless of whether it has actually caused the damage (the liability is propter rem).

7 Protection against liability

How can owners protect themselves from liability and what types of insurance can they obtain?

Further to the due diligence, the main remedy for liability is the inclusion of strong representations and warranties in the purchase and sale agreement. Typically, the vendor assumes all liability arising from events that occurred until the transfer of possession to the buyer. Environmental, property, construction and civil liability are examples of insurances that may be acquired to reduce an owner's or lessor's exposure regarding real estate liability.

8 Choice of law

How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

Contractual choice of law provisions are enforceable unless otherwise determined by law. In this sense, Brazilian law necessarily governs any claim regarding possession or ownership of real estate located in Brazil and the Brazilian judicial authority is the one entitled to judge claims in connection therewith.

9 Jurisdiction

Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

Under Brazilian law, there is no specific court with subject-matter jurisdiction over real estate disputes. In most cases involving disputes related to real estate, the court with jurisdiction is the venue where the property is located. For a claim to proceed, all the defendants must be summoned to court. Out-of-court jurisdiction service is done through the court. The court with jurisdiction over the matter issues an official order to the court with jurisdiction over the person in order to complete the service of process. Parties need not be qualified to do business in order to enforce remedies in Brazil. In order to have access to any court, a party not resident in Brazil with any real estate within the country's territory must deposit in an account managed by the court sufficient funds to pay court costs and expenses and the other party's counsel's fees as determined by the court, if he or she is the prevailing party.

10 Commercial versus residential property

How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

Real estate ownership, financing and enforcement do not differ between commercial and residential property. A tenancy, on the other hand, has some specific legal provisions that are not applicable to both. The Federal Lease Law mainly governs the lease of urban real estate (commercial and residential). To stimulate the development of economic activity, the Federal Lease Law has a specific procedure exclusively applicable to commercial property known as compulsory renewal. Once the requirements are met, the lessor is compelled by the judge (thus the right depends on filing a claim) to renew the lease for a predetermined period equivalent to the original term.

11 Planning and land use

How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

The Brazilian federal constitution sets out that the municipal entity has competence to regulate matters of local interest. A directive plan, approved by municipal law and revised every 10 years, is the basic instrument for urban development and expansion. It is mandatory for cities with more than 20,000 inhabitants or that integrate metropolitan regions, among others. The directive plan regulates aspects such as pre-emption rights of the municipality to acquire areas subject to transfer between private entities, construction limits and the possibility of onerous acquisition of construction rights above standard limits.

There are also local zoning and federal and local subdivision laws. Local subdivision laws should not be contrary to federal subdivision laws, but may be more specific for addressing the interests of the locality. Anyone interested in construction is required to have the project approved and to obtain a construction licence. Usually municipal approval is granted after an opinion about the project, uses and limits is issued by applicable local bodies, such as environmental, traffic, historical protection and land use. Depending on each project, licences from state and federal authorities may be applicable.

12 Government appropriation of real estate

Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

The Brazilian government is entitled to promote the compulsory purchase of rural and urban real properties by means of expropriation. The expropriation may be promoted in the public interest or social interest, duly recognised by specific law. The expropriation relies on the payment, by the respective entity, of prior and fair compensation to the owner. The owner is entitled to judicially discuss the amount of the compensation offered by the government, but not the expropriation act itself. Lessees are also entitled to request compensation for the expropriation, and the compensation should not be offset at first from the amount paid to the owner.

13 Forfeiture

Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

The use of real property for the cultivation of illegal drugs, as well as the use of slave work, may cause the owner to forfeit its real estate without any compensation, by means of an expropriation brought by the government. In these cases, the government will confiscate all profits related to the illegal activity.

14 Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency system in your jurisdiction.

Under the Brazilian bankruptcy and insolvency system, debtors can file voluntarily for an extrajudicial or judicial reorganisation and file voluntarily for liquidation or be forced into liquidation by creditors. Brazilian bankruptcy and restructuring law sets out the rules and procedures of extrajudicial and judicial reorganisations, which consist of an arrangement between the debtor and its creditors, under the supervision of the judiciary, directly initiated by the debtor itself. Extrajudicial reorganisations are less common and are similar to a prepackaged Chapter 11 procedure in the US. The Brazilian prepackaged reorganisation is a proceeding designed to overcome the distressed situation in an expedited way, restructuring specific categories of creditors as determined by the debtor before the filing. The restructuring plan is negotiated by the debtor and certain predetermined creditors ahead of the actual filing.

Judicial reorganisations can be filed by debtors that:

- have exercised regular business activities for at least two years;
- have not been declared bankrupt in the past eight years nor have been subject to a judicial reorganisation procedure in the past five years; and
- have not been convicted for any bankruptcy crime.

Creditors collateralised with fiduciary liens and tax claims are not submitted to judicial reorganisation. After the filing, the debtor cannot sell or encumber its fixed assets without the Bankruptcy Court's authorisation, unless the sale or encumbrance is provided for by the reorganisation plan and the respective creditors´ general meeting duly approves the plan. Sellers, buyers, landlords, tenants or lenders are affected only in their pre-petition claims that will be restructured according to the restructuring plan presented by the debtor. Post-petition obligations must be fulfilled by the debtor, regardless of the filing, including rents owed by the company during the judicial reorganisation proceeding. In judicial reorganisation proceedings, valuations are common to appraise assets given as collateral to creditors, in order to determine the amount of the credit that is secured and unsecured. Finally, liquidation can be filed either by creditors and debtors and can also result of a failed judicial reorganisation.

Investment vehicles

15 Investment entities

What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

Investment entities in Brazil can be structured from different forms, such as incorporated entities (eg, *sociedades limitadas*, similar to limited liability companies, and *sociedades por ações*, similar to corporations), investment funds or contractual joint ventures. Currently there are no applicable pass-through rules in Brazil. Nevertheless, provided that income derived by investment funds is exempt from taxation and taxed upon distribution to shareholders (subject to specific rules), the use of funds usually works as a tax-deferral alternative.

16 Foreign investors

What forms of entity do foreign investors customarily use in your jurisdiction?

The main entities used by foreign investors are:

- private equity investment funds (FIPs);
- *sociedades limitadas*; and
- *sociedades por ações*.

FIPs are a type of investment fund (a collective investment vehicle) designed to invest in debentures, subscription warranties or other securities convertible into or exchangeable for stock issued by *sociedades por ações* in Brazil. More recently, FIPs have been allowed to invest in equity participation of *sociedades limitadas* in Brazil. FIPs are by far the most popular private equity vehicle in Brazilian M&A practice. *Sociedades limitadas* and *sociedades por ações* have similarities to US limited liability companies and corporations, respectively. A *sociedade por ações* allows for increasingly complex capital structures and corporate governance and access to the Brazilian capital markets. A *sociedade limitada* has more straightforward structuring, but equally effective legal protection.

17 Organisational formalities

What are the organisational formalities for creating the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

The basic requirement for creating a *sociedade limitada* is the preparation of its articles of association, and by-laws in case of a *sociedade por ações*, and filing of such documents with the regional Board of Trade. Foreign shareholders must grant power of attorney to a Brazilian resident with, among others, powers to receive service of legal process on behalf of such shareholder. In order to operate in Brazil FIPs must first be registered with the Brazilian Security Commission (CVM) and are subject to the CVM's oversight. FIPs shall comply with the provisions of CVM Rule 578/16 and are subject to reporting requirements to the CVM and their investors (quotaholders). Only qualified investors, as defined by CVM regulation, may invest in FIPs. The FIP must be organised as a closed-end condominium and represented by an administrator registered with the CVM. Income derived from incorporated entities, such as *sociedades limitadas* and *sociedades por ações*, are subject to regular taxation, according to the tax regime adopted by the entity in practice. Dividend distribution, on the other hand, is exempt from taxation (including distribution to foreign investors). Investment funds, in turn, are exempt from taxation. However, profit distribution to its quotaholders is subject to taxation according to specific rules (if legal requirements are met, profit distribution to foreign investors is also tax-exempt in specific cases). In this sense, finding the most efficient tax structure will depend on a case-by-case analysis, considering the type of business activities conducted in Brazil.

Acquisitions and leases

18 Ownership and occupancy

Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

Besides ownership, there are other categories of in rem real estate rights, such as surface (similar to ground lease), usufruct, use, housing and concession (for housing or use). Surface right is getting more relevant under real estate deals, especially for foreign investors. All of them are constituted by the execution of a deed (exception if otherwise allowed by law) and its recordation at the competent real estate registry office. Leases may be recorded for certain effects, but it is not mandatory since a lease is not an in rem right. Condominiums are common and regulated by law. Associations are also common but there are several issues able to be discussed in connection therewith. Lease rules differ slightly for residential and commercial purposes, but mostly the rules are similar.

19 Pre-contract

Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

There are non-binding agreements that can be executed before the contract of sale, such as a letter of intent or a term sheet. The law does not determine the format of such agreements. The parties usually agree to take the real estate off the market (exclusivity) until the execution of a binding agreement or discontinuance of the deal. The non-binding agreement is not enforceable by Brazilian courts in the

sense that one party may be compelled to sell or to buy. Each party may, however, claim for loss and damage that eventually arise from the non-compliance of any agreed term. Binding sale agreements comprise a preliminary agreement (purchase and sale commitment, usually assuming a private form) and a definitive purchase and sale agreement (usually a public deed executed in the presence of a notary). Basically, the scope of the purchase and sale commitment is to give time to the parties to solve issues that may jeopardise the definitive acquisition, such as the conclusion of the due diligence (on the buyer's side) or the regularisation of the title chain before the real estate registry office (on the vendor's side). The purchase and sale commitment is an instrument that may be recorded, and may entitle the buyer to promote the compulsory transfer of the real estate.

20 Contract of sale

What are typical provisions in a contract of sale?

The main conditions in a contract of sale are the parties, the object and the acquisition price. It is customary to execute a purchase and sale commitment that will be followed by a public and definitive deed of purchase and sale. The purchase and sale commitment may be executed if the price is not fully paid at first sight, and is regularly executed to grant buyer a term to conduct a proper due diligence. It is common to make a down payment of 10 to 20 per cent, depending on the stage of due diligence, that shall always begin with the analysis of the real estate certificate of enrolment, held at the competent real estate registry office.

The representations and warranties will reflect the stage of the due diligence upon the execution of the purchase and sale commitment and shall be reinstated in the deed of purchase and sale. Taxes and expenses related to the execution and recording of the definitive deed of sale are commonly held by the buyer (it may be agreed otherwise) and the expenses incurred in the event of non-conclusion of the deal are shared, except if the non-conclusion is due to a breach by one party.

21 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

The owner, tenant or occupant by any title of real estate are jointly and strictly liable for carrying out the environmental clean-up, regardless of the causation of the damage, though they are able to pursue reimbursement of any such losses by recourse against the perpetrator of the damage. Clean-up obligations, as with the reparation of any environmental damage, are not subject to the statute of limitations. Therefore, survival provisions are critical to ensure that the seller will carry out the long-term legal obligations associated with the clean-up, thus limiting the buyer's exposure to civil liability, environmental sanctions and criminal liability associated with land contamination.

22 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

The typical representations are related to the existence of the lease agreements and the absence of any breach by both parties under the terms of the respective agreements. Since, normally, lease agreements are not executed under confidentiality clauses, the buyer is able to analyse all lease agreements related to the target real estate during its legal due diligence period. In addition, if a lease is executed with an enforceability clause, the respective instrument may be recorded before the real estate enrolment. Moreover, granting the tenant the right to continue its lease even if the leased real estate is sold to a third party, such record grants publicity to the lease agreement, which means that anyone may request a copy of the instrument before the competent real estate registry. During the negotiation of an acquisition, normally the seller does not execute new agreements, but in specific cases, such as shopping centre acquisitions, the parties may agree differently.

Estoppel certificates area not applicable under Brazilian law.

23 Leases and real estate security instruments

Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

The subordination of the lease does not rely on the instrument's provisions, but on the priority of each title (lease and security instrument) recorded before the competent real estate registry. The lender should evaluate its priority by analysis of the certificate of enrolment of the proposed real property. Subordination and non-disturbance agreements are not common but are feasible in Brazil.

24 Delivery of security deposits

What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

In a sale transaction, the security deposit may be transferred to the buyer upon payment of the full acquisition price, since, after such payment, and the conclusion of the sale, the buyer assumes the position of lessor on the lease, if it does not terminate the respective agreement, as authorised by the Brazilian Lease Law. A security deposits is one of the four kinds of guarantees provided in the Lease Law, along with personal guarantee, rent insurance and fiduciary assignment of investment funds shares (the less used guarantee). Currently, security deposits are not the most common guarantee owing to the limitation imposed by law of a maximum amount of three months' rent that, nowadays, does not normally gives the necessary security for the landlord.

25 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain a zoning report or legal opinion regarding legal use and occupancy?

The basic document is the certificate of enrolment, issued by the competent real estate registry office. This document, however, does not contain all the information to evaluate the risks that may arise from the acquisition, a reason why other documents are recommended to be analysed: title, tax certificates, searches about expropriation, environmental and zoning, certificates issued by specific courts. The purpose is to identify possessory or petitionary lawsuits and whether the acquisition may be deemed null or void by virtue of fraud. A federal law enacted in 2015 establishes that legal transactions aiming at creating, transferring or modifying in rem rights over real property will have their effectiveness guaranteed if the preceding transactions have not been recorded in the real estate enrolment. However, the law conflicts with other laws and it is necessary to await its interpretation by the courts to understand if the analysis of one single document (the enrolment) would cover any legal issues related to the real property acquisition. A legal opinion to be issued by lawyers practising real estate law is recommended prior to the acquisition.

Brazil does not have a mature and sophisticated title insurance industry. A technical due diligence prior to the acquisition is recommended relating to environmental, zoning and other relevant aspects to the specific case, specially when referring to rural or industrial lands. Brazil has a statutory priority system applicable to registered or recorded rights. Priority among interests can be reordered by contract

between the parties (a first-priority creditor may agree to assign its priority to a second-degree in the benefit of another creditor).

26 Structural and environmental reviews

Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

Engineering and environmental reviews are strongly recommended and common depending on the land characteristics. They are conducted simultaneously with the legal due diligence to provide the buyer a realistic view of the real estate issues and enable the parties to include the proper representations, warranties and indemnities on the acquisitive agreements. As mentioned in question 7, environmental insurance is available,but owing to the cost is not commonly used.

27 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

Yes, lawyers usually review leases, specially the most relevant ones (relevance is dictated by the specific case, depending on, for example, value, duration, improvements or location). The most relevant aspects to be reviewed by the lessee are effectiveness, renewal, collateral, licences and ownership.

28 Other agreements

What other agreements does a lawyer customarily review?

A lawyer expert in the agreement subject matter should review any agreement. Agreements that are subject to recording (easements, securities) should be reviewed by lawyers to check not only material but also formal aspects, once recording is a requisite for the agreements to produce effects against third parties. Brokerage agreements are usually standard, which does not preclude revision by a lawyer.

29 Closing preparations

How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

As for real estate acquisitions and loans, the contract and the closing take about 60 to 120 days. Legal, environmental and technical due diligence are the basic requirements. Once they have been accomplished, a common preparation for such deals is the confirmation of the applicable powers and authorisations of the parties. Since a definitive acquisition relies on the execution of a public deed by a notary, it is important to confirm if all documents that are necessary for such act are available and valid. The payment is normally made by electronic transfer at the same time of the execution of the acquisition deed. On financing, the funds are usually released in up to 48 hours from the execution of the loan instrument or from the recording of the title. The closing of a lease is easier since it does not have as many formalities.

30 Closing formalities

Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

The closing of a transfer of a real estate appraised above 30 minimum national wages is executed under a public deed in the presence of a notary, with all parties present at the signing. Leasing and financing must be executed by all parties at the same time; however, these transactions do not require the presence of a notary since the respective agreement may be executed by private instrument.

31 Contract breach

What are the remedies for breach of a contract to sell or finance real estate?

The parties are entitled to claim for damages arising from a breach in an acquisition or finance agreement. The purchaser, by means of a legal procedure called compulsory adjudication, may enforce a fully paid purchase and sale commitment. A borrower's breach of a finance agreement is usually solved by forfeiture of the collateral.

32 Breach of lease terms

What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply?

Federal lease law dictates the main aspects of the relation between lessor and tenant, including the evicting procedure in the event of default. In specific cases a preliminary injunction to eviction can be ruled. Besides the eviction, a lessor may execute its guarantees according to the specific events of default. A lessor's breach, on the other hand, is basically solved by general contract rules contained in the federal Civil Code, including the possibility of claiming for loss and damage.

Financing

33 Secured lending

Discuss the types of real estate security instruments available to lenders in your jurisdiction.

There are two security instruments governing real property in Brazil: mortgage and fiduciary transfer of collateral.

By the fiduciary transfer, the transitional owner sells for a short-term the ownership of its real property to the fiduciary creditor. In turn, the fiduciary creditor does not acquire full ownership of the real property intending to keep it in its pool of assets in a definitive manner. Once the debtor complies with its obligation, the property reverts to its pool of assets. In the event of a default by the debtor, there will also be extinction of the resolvable property by 'consolidation' of the property on behalf of the fiduciary creditor.

The fiduciary transfer differs from other in rem rights, such as mortgage, because in these cases the holder of the collateral guarantee has rights over the third party's property, that is to say, the object of the collateral remains under the control of the debtor. A mortgage allows the real property to be granted in the second degree for guaranteeing another owner's debt. If an event of default occurs, the creditor needs to enforce the mortgage in court, where the auction will occur.

34 Leasehold financing

Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

There is no specific financing for leases in Brazil. There are securitisation transactions backed by lease rents. There is financing for any type of transaction involving real estate, whose terms basically depend on the Brazilian economic situation at the time, the debtor's economic situation and commercial conditions or guarantees to be agreed upon by the parties.

35 Form of security

What is the method of creating and perfecting a security interest in real estate?

The fiduciary property may be executed under private instrument, while the mortgage demands a public deed to be drawn up in front of a notary (notary fees apply). Both need recording to produce effects against third parties.

36 Valuation

Are third-party real estate appraisals required by lenders for their underwriting of loans? Must appraisers have specific qualifications?

Notwithstanding the absence of legal requirements, the valuation of real estate is strongly recommended and almost a rule on financing deals. Appraisers are not required to have any specific qualification to value real estate that will be the object of a loan. However, the common rule is to use appraisers with recognised expertise on the analysis of real estate with similar conditions to the one that will serve as collateral for the loan.

37 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

Loan agreements between a Brazilian borrower and a non-Brazilian lender are subject to electronic registration with the Brazilian Central Bank. In order to be accepted by Brazilian courts, agreements executed in other jurisdictions must be notarised, legalised and filed with the Registry of Titles and Deeds, together with a sworn translation into Portuguese. Foreign lenders do not have to be qualified or licensed to do business in Brazil, but must be enrolled with the Brazilian taxpayer registry. The acquisition by foreigners of rural properties in Brazil is subject to certain restrictions, as discussed above (question 4), which may affect the enforcement of the security instrument in such cases. Lien documents must be recorded with the real estate registry, which involves certain fees (variable according to the property's value and location). Transfer taxes are due if the real property ownership in transferred as a result of enforcing the lien. Security instruments can be amended to be assigned, but the amendments will also need to be recorded, with the payment of additional fees. Depending on the modifications in the debt's or securities' conditions it will be necessary to execute a new instrument to replace the previous one.

38 Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

Interest rates on loans for the acquisition of real properties in Brazil are usually capped by benchmark SELIC base interest rate (currently fixed on 14.25 per cent a year). However, this cap is market practice since financial institutions are not limited to the SELIC rate as are other entities. It is deemed abusive if interest rates are practised above market averages (which may include fees and lender costs) and Brazilian courts admit the compulsory revision of the rates in such cases.

39 Loan default and enforcement

How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

In most cases creditors must seek judicial protection to enforce the collateral and receive their payments if the debtor did not fulfil any obligation. The remedies available and the time consumed by each of the alternatives depend on the relationship between the creditor and the debtor and how the relevant agreements have been formalised. As a rule, creditors can only seek one remedy against the debtor in order to enforce an agreement or foreclose on the collateral. In any case, to seek payment of monetary obligations, creditors are not limited to enforcing the collateral originally granted to the financial agreements. A debtor's financial liability arising from a certain debt comprises all the assets available to pay the debt, even though creditors prefer to enforce the collateral. Creditors can also seek specific performance if non-monetary obligations have been defaulted. Monetary obligations are enforced in court, which allows immediate attachment of assets. Some requirements regarding the proof of claim are necessary to allow the collection of a certain debt through the filing of an enforcement proceeding. Generally, after the commencement of the proceeding, creditors are entitled to indicate the debtor's assets to be attached. Debtors have also the right to indicate their own assets to be attached, including those granted as collateral to the same creditor or plaintiff, because of the principle stating that enforcement proceedings must be as little a burden as possible to the debtor. Any attached assets will be subject to an appraisal during the enforcement proceeding before being sold to third parties (through a public auction or the creditor itself). If the agreements do not allow creditors to file an enforcement proceeding, they may opt to file collection lawsuits, which are proceedings provided by the Code of Civil Procedure, with a much slower track compared with the above-mentioned enforcement proceedings and without the possibility of attachment of assets until a final decision on the merits is granted by the competent court. There are no strict legal requirements regarding the proof of claim to commence collection lawsuits.

40 Loan deficiency claims

Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

Any deficiency may be (and usually is) recovered by lenders, which usually occurs within the same lawsuit filed to foreclose the security. The statute of limitations is applicable, being of five years for credits secured by private or public contracts. Exceptionally, a credit secured by a fiduciary transfer is not entitled to recover for deficiency. The law determines that this type of security is foreclosed out-of-court and a lender that chooses such security, under the power of sale, cannot obtain a deficiency judgment against the borrower.

41 Protection of collateral

What actions can a lender take to protect its collateral until it has possession of the property?

As a rule, property granted as collateral stays in the debtors' possession. If the debtor defaults on its obligations, the lender is entitled to seek judicial protection (for mortgages) or initiate a foreclosure proceeding in a public registry (for fiduciary transfers) in order to have its debt paid and take possession of the property. Lenders whose credits are collateralised by fiduciary transfers are entitled to collect rents from the debtor for the period between the sale of the property and the date in which it effectively takes possession. Creditors whose credits are collateralised by mortgage are not entitled to collect rents, since the possession of the real estate is only transferred to the lender upon the conclusion of the judicial foreclosure.

42 Recourse

May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

The recourse to all of the assets of the borrower is statutory and does not depend on the parties expressly agreeing so. Collateral is contracted to link specific assets to the repayment and to ensure priority. Bankruptcy or insolvency filings affect recourse once creditors are organised under statutory priority. Even lenders secured by collateral can use recourse prior to or later than the collateral foreclosure.

43 Cash management and reserves

Is it typical to require a cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

Financial agreements in Brazil often involve cash management systems and escrow accounts. The nature and purpose of such systems will depend on the complexity of the transaction and the status of the property. In the most sophisticated construction projects, the lender will require all revenues to be deposited in escrow accounts not freely managed by the borrower.

44 Credit enhancements

What other types of credit enhancements are common? What about forms of guarantee?

Letters of credit are a very good type of credit enhancement because of their liquidity; however, borrowers avoid them because of the high cost. Completion and performance bonds are common for construction loans. Enforcement occurs through a notice to the insurance company and proof of default. It may be challenged in court by any of the parties.

45 Loan covenants

What covenants are commonly required by the lender in loan documents?

Typically, lenders will require covenants restricting the creation of new liens over the company's assets or new debt, and obliging the borrower to maintain the real property in good condition and to pay real estate taxes and expenses when due. It is common to require the maintenance of certain insurance policies, with the lender as beneficiary, and the replacement of liens if a depreciation occurs. The inclusion of covenants requiring compliance with applicable laws, especially labour, environmental and anti-corruption laws, has been a growing concern for Brazilian lenders.

46 Financial covenants

What are typical financial covenants required by lenders?

Typical financial covenants in Brazilian loan agreements may include debt-service coverage ratios and net debt/EBITDA ratios and restrictions of new liens on the assets. Lenders will usually require that the borrower has its financial statements audited by independent auditors (sometimes, specific firms will be required). It is common to require ongoing appraisals, usually on an annual basis.

47 Secured moveable (personal) property

What are the requirements for creation and perfection of a security interest in moveable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

The encumbrance of moveable property is generally constituted by means of pledge or fiduciary transfer. Both can be formalised by means of a private instrument, and to produce effects before third parties such instrument must be recorded at a public registry (a real estate registry office or a registry of deeds and documents, depending on the nature of the asset). Security interest over vehicles is recorded before the proper traffic authorities.

48 Single purpose entity (SPE)

Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

An SPE is merely a qualification that *sociedades limitadas* or *sociedades por ações* receive when their core business description, indicated in their corporate documents, is for a specific purpose, normally to be concluded in a specified period. There is no concept of independent director specifically for an SPE since this is not a specific Brazilian corporate type.

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General

1 Legal system

How would you explain your jurisdiction's legal system to an investor?

For the first hundred years or so from becoming independent in 1844, the Dominican Republic had a legal system based on French law, specifically on the Napoleonic Codes – Civil, Civil Procedure, Commercial, Criminal and Criminal Procedure – under a Constitution based on the American model, with three branches of government: a strong presidency, a legislature and a judiciary with the power to strike down acts of the other branches found to be unconstitutional. Since the first half of the 20th century, however, there has been a tendency away from the French model, with the adoption of many statutes and codes inspired by other legal systems: for example, the Land Registry Law of 1920, founded on the Torrens System, of Australian origin; the Labour Code of the 1950s and 1992, modelled on South American codes; the new Code of Criminal Procedure of 2002, based on the same adversarial principles that govern American criminal litigation; the new arbitration statute of US principles; the new arbitration statute in 2008, taken from the model arbitration code prepared by the United Nations, and the recently enacted bankruptcy and insolvency statute, influenced greatly by American bankruptcy law.

The Constitution of the Dominican Republic lays out the fundamental framework for the organisation and the operation of the Dominican government and its institutions, and recognises an impressive list of civil rights for all individuals, Dominicans and non-Dominicans, including an equal protection clause for non-Dominican citizens and investors. Article 25 of the Constitution expressly states that foreign nationals are entitled to the same rights and duties in the Dominican Republic as Dominican nationals, except – understandably – for the right to take part in political activities. Article 221 of the Constitution sets forth that the government will ensure equal treatment under the law for local and foreign investments.

Individuals and entities, domestic and foreign, have a quick and inexpensive remedy for the protection of their constitutionally protected rights: the writ of *amparo*, which is granted by all courts and is subject of an appeal to the Constitutional Court.

Cases in Dominican courts are decided by judges not by juries. Judges rule based on the texts of the Constitution and existing statutes, the precedents of the Constitutional Court (which are binding), and the precedents of other courts (which are not binding). They do not rule in equity, as in some common law countries, but the principle of good faith is recognised by statutory law and grants the courts some discretion. Punitive damages are not awarded in injury cases, just compensatory damages.

Finally, regarding evidence, parol evidence is admissible in criminal, labour and commercial matters, and, under certain circumstances, in civil and real estate matters.

2 Land records

Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

As mentioned, the Dominican Republic has employed, since 1920, the Torrens system for real estate registration purposes. This system was developed in Australia in the 19th century and is now widely used in many countries. In the Torrens title system, a register of land holdings is maintained by the government, which guarantees an indefeasible title to the properties included in the register. Land ownership is transferred through registration of title instead of using deeds. The registrar has a duty to ensure that only legally valid changes are made to the register. Any interest affecting or limiting the ownership rights of the registered owner, such as mortgages, easements, liens, etc, must also be registered. Interest in real estate (property, mortgages, privileges, etc) is only valid and enforceable against third parties upon registration at the office where the register is located (called 'Registry of Title' in the Dominican Republic). Once registered, the system guarantees title and priority on a first come, first served basis.

In the Torrens system a third party, acting in good faith, can rely on the information on the land register as to the ownership of a property and the other rights and interests that may affect it. In a property purchase, the buyer is not required to look beyond the record at the register. In contrast, in the common law system a vendor cannot transfer to a purchaser a greater interest than he or she owns, and the seller's title is as good or as defective as the weakest link in the chain of title, which necessitates a chain-of-title investigation at the record office.

As in most jurisdictions under the Torrens system, there are still some parcels of land in the Dominican Republic that are unregistered. However, most properties in the country – and 100 per cent of commercial properties – fall under the registered category. Unregistered property is governed by the French 'ministerial' system, whereby deeds affecting real estate are filed at a specific register that only serves as a recorder of documents, without any type of guarantee.

3 Registration and recording

What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

The legal requirements for recording conveyances are the following:

- deed of sale (sales contract), authenticated by a Dominican notary;
- certificate of title issued to the owner by the Registry of Title (a completely different document from the deed of sale), which serves as the only proof of ownership;
- certification showing that the seller is up to date with its property taxes;
- receipt attesting to the payment of the real estate transfer taxes (3 per cent of the government-appraised value of the property). In some cases (ie, first purchases in certain tourism projects, low-cost housing acquired with a bank loan), the buyer is exempt from this tax; and
- copy of the ID card or passport of the parties, or tax card if a legal entity. Non-resident foreigners need to provide an additional ID card from their country of origin in addition to their passports.

Registration rules are established by the General Director of the Registries of Title and are applicable nationwide. The Dominican Civil Code states that buyers pay all the fees, expenses and taxes required for conveyances unless agreed otherwise by the parties.

4 Foreign owners and tenants

What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

There are no restrictions on foreign individuals or entities owning or leasing real estate in the Dominican Republic. The process for purchasing or leasing real estate for foreigners is exactly the same as for Dominicans. Both foreign individuals and entities, and Dominicans, must register locally with the tax authorities before registering purchases of real estate. Individuals must submit their application directly at the Internal Revenue office, while entities must first register at the Chamber of Commerce and obtain a mercantile registry certificate, before applying for their tax number. These are mere formal requirements that can be easily fulfilled.

5 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

Real estate can be purchased and sold in any currency, usually in local currency (Dominican pesos) or US dollars. There are neither controls nor restrictions on foreign currency exchange in place. Under current foreign investment laws, foreigners can freely repatriate capital and profits from their investment in the Dominican Republic.

6 Legal liability

What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

Owners and tenants face a standard strict tort liability (custody-based liability) for the real estate they own or lease for damages suffered by third parties on their property, if the property has played an active role in causing the damage, or for environmental damages. Only current owners or tenants at the time of occurrence of the damage can be held liable, not subsequent owners or tenants. Lenders are exempt.

7 Protection against liability

How can owners protect themselves from liability and what types of insurance can they obtain?

Owners can protect themselves by acquiring a civil liability insurance policy. The environmental law requires mandatory insurance for projects that require a permit from the Ministry of Environment. There are no legal structures in place that can shield owners from their liabilities.

8 Choice of law

How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

The Dominican Civil Code mandates that all matters concerning real estate in the Dominican Republic are subject only to local law, no matter who owns the property (Dominican citizen or foreign individual entity) or the place where the contract was signed. This is a rule of public order that cannot be amended or waived by the contracting parties. If a transaction involves properties from another jurisdiction as well, then the part of the transaction that refers to the Dominican real estate must be governed by Dominican law, hence all closing documentation must be drafted and executed according to Dominican laws. Nevertheless, for estate purposes, a new conflict of laws statute, enacted in December 2014, allows foreigners to have their national law determine the rules of inheritance in connection with real estate located in the Dominican Republic; previously, Dominican inheritance rules applied in all cases.

In contractual matters not involving real estate, the parties can choose the applicable law as long as they do not breach public order provisions under Dominican law. For example, labour relations in the Dominican Republic must be governed by Dominican law.

9 Jurisdiction

Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

The Real Estate Registration Law provides a special jurisdiction for disputes over registered real state, consisting of land courts of original jurisdiction, with a single judge, as a court of first instance, and superior land courts, with five judges, as appeal courts. Both decide on matters of fact and law. Decisions of a Superior Land Court may be appealed before the Supreme Court, which only verifies the correct application of the law.

All affected parties in a suit must be duly notified by bailiff before he or she can proceed. For parties domiciled abroad, notices are served through a special procedure established for this purpose through the Dominican consulate in the country where the party is domiciled.

A foreign party does not need to be qualified to do business in the Dominican Republic, nor is required to post a litigation bond to sue for remedies in the Dominican Republic.

10 Commercial versus residential property

How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

In general, Dominican law does not distinguish between commercial and residential properties: the same rules apply for both. However, properties held by commercial entities are taxed differently from those owned by individuals.

A 1 per cent annual tax is assessed on real property owned by individuals, based on the cumulative value of the properties owned by the same individual, as appraised by the government authorities. Properties are valued without taking into account any furniture or equipment to be found in them. For built lots, the 1 per cent is calculated only for values exceeding 6.8 million Dominican pesos. For unbuilt lots, the 1 per cent tax is calculated on the actual appraised value without the 6.8 million pesos exemption. Individuals pay this tax every year on or before 11 March, or in two equal instalments: 50 per cent on or before 11 March, and the remaining 50 per cent on or before 11 September. The 6.8 million pesos threshold is adjusted annually for inflation. The following properties are exempt from the property tax:

- built properties valued at 6.8 million Dominican pesos or less;
- farms; and
- houses inhabited by owners who are at least 65 years old, who have owned the house for more than 15 years and have no other property in their name.

Properties held in the name of a corporation or other entities do not at present pay a property tax per se; however, a 1 per cent tax is levied on company assets, including real estate. Beginning in 2017, however, property held by entities will also pay a 1 per cent property tax, and the tax on assets will be abolished.

There are also different tax treatments with regard to leasing to individuals or to corporate entities: the leases to entities are subject to value-added tax; leases by individual landlords are subject to a 10 per cent withholding tax that is credited toward the landlord's annual income tax.

11 Planning and land use

How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

All planning and land use matters are handled by the municipalities, the Ministry of Tourism (in tourist areas) and by the Ministry of Environment. The municipalities and the Ministry of Tourism establish the general rules regarding use (residential, commercial, industrial, mixed, density, maximum height, etc). Any construction or development that may affect the environment must also be approved by the Ministry of Environment.

12 Government appropriation of real estate

Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

The legal regime for government compulsory purchase or condemnation of real state is established by the Constitution and Law 344 of 1943. The Dominican Constitution states that:

> *No person shall be deprived of his or her property, except on justified grounds of public utility or social interest, for which a person shall be paid a fair value before expropriation, as determined by the mutual consent of the parties or by the judgment of a court of competent jurisdiction, pursuant to the law. In case of the declaration of a State of Emergency or Defense, compensation may not be paid before the expropriation.*

Law 344 establishes the specific procedure that the government must follow in any case of expropriation.

13 Forfeiture

Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

The Constitution allows the government to seize property without compensation if a definitive court ruling has confirmed that the property has been obtained through illegal acts such as drug trafficking, money laundering, etc.

14 Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency system in your jurisdiction.

Bankruptcies are presently regulated by the archaic procedure established in the outdated Code of Commerce, being the reason why it is almost never used. However, special regulations govern insolvency in the banking, insurance, energy and pension funds sectors. As a general rule, bankruptcies are only applicable to merchants and companies, not to individuals who are not merchants.

Secured creditors are not affected by a bankruptcy process; they maintain their priority rights over their collateral. Compulsory or voluntary reorganisation of an insolvent debtor does not exist.

A modern bankruptcy and insolvency statute, modelled on US bankruptcy laws, was enacted in August 2015 and will be in effect from January 2017.

Investment vehicles

15 Investment entities

What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

There are no restrictions regarding the structure or legal form of a foreign entity. If it is duly incorporated and recognised in the jurisdiction where it was formed, entities can do business in the Dominican Republic upon registration at the Chamber of Commerce and Internal Revenue. However, trusts as they are known in most common law jurisdictions are not recognised as legal entities and cannot, therefore, directly hold property in the Dominican Republic.

As for Dominican entities, Dominican company law allows different types of commercial companies (individually owned enterprise, LLC) and corporations (regular or simplified stock corporations), all of which provide limited liability for its owners or shareholders. There are other investment entities recognised under the law, such as business partnerships, limited partnerships and per share limited partnerships, but they are seldom used because they do not offer a full liability shield to their members, and are subject to the same tax treatment as the other entities. Also, the recently enacted Law 189-11 introduced local fiduciary vehicles as a holding option.

Local law does not recognise the concept of pass-through entities. Any entity, local or foreign, is taxed as an entity, regardless of its legal structure, except real estate assets held through a closed-end investment fund approved by the Dominican Republic Security and Exchange Superintendence. These funds are considered fiscally neutral investment vehicles and, as such, are not subject to income tax; their shareholders or beneficiaries, however, will pay income tax on the income received from the funds.

16 Foreign investors

What forms of entity do foreign investors customarily use in your jurisdiction?

The most common entity used by foreign investors is a local LLC. Some, preoccupied by the complexities of reporting a foreign entity to the tax authorities in their home jurisdiction, prefer to register their domestic entity in the Dominican Republic. Finally, high-income individuals with complex estate planning in place use the structures existing in their estate plan to acquire Dominican assets.

17 Organisational formalities

What are the organisational formalities for creating the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

The five basic steps for incorporating any local entity are:

- registering the company's name before the National Office of Industrial Property;
- signing of the by-laws;
- payment of the incorporation tax (1 per cent of capital);
- recording the incorporation documents at the Chamber of Commerce and obtaining the mercantile registry certificate; and
- registering the company at Internal Revenue and obtaining a tax number.

The three basic steps for registering a foreign entity in the Dominican Republic (permanent establishment) are:

- translating into Spanish and authenticating the incorporation documents (by-laws, certificate of incorporation, designation of directors, etc);
- recording the incorporation documents at the Chamber of Commerce and obtaining the mercantile registry certificate; and
- registering the company at Internal Revenue and obtaining its tax number.

All foreign and local entities are taxed equally regardless of structure: a flat 28 per cent on net corporate profits and 10 per cent tax on dividends or profits sent abroad.

The Dominican tax code has a general anti-tax avoidance provision ('substance over form' principle) and specific rules for the sale of shares of foreign entities that own assets in the Dominican Republic.

All companies registered in the Dominican Republic, regardless of their being local or foreign entities, including those with no income or operations, must file income tax returns with the Dominican Republic's Tax Office (DGII) every year. Aside from the penalties on overdue taxes, which amount to 11.10 per cent for the first month and 5.10 per

cent for each additional month, entities that do not comply with the filings and subsequent payments of both income and asset taxes run the risk of having the Tax Office begin a lien registration process against the entity's properties.

Acquisitions and leases

18 Ownership and occupancy

Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

Dominican real estate law recognises the following interests in real estate:

- absolute ownership;
- usufruct;
- easements;
- betterments;
- leases;
- condominium regimes; and
- privileges and mortgages.

It does not recognise cooperative ownership arrangements or other occupancy interests.

19 Pre-contract

Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

Non-binding agreements do not really fit into the Dominican legal system and are rarely used. A general rule of the Civil Code establishes that with an agreement on the property and the sale price, the sale is perfected between the parties, even if the property has not been delivered nor the price paid. Although this rule can be waived, it is customary to characterise any agreement – including term sheets – as binding, meaning that penalties are applicable if, for example, the buyer decides not to buy or the seller decides not to sell, even in cases when the above-cited rule is subject to a suspensive condition. An agreement is usually considered as binding and will be treated by the courts accordingly.

Customarily, real estate transactions in the Dominican Republic do not follow the North American pattern of a written offer tendered by the buyer to the seller, followed by the seller's written acceptance, or the signing of a non-binding term sheet or letter of intent. Instead, after verbal agreement is reached by the buyer and seller on the price, a binding Promise of Sale is prepared and signed by the parties. A property is usually only taken off the market if a binding contract with a non-refundable deposit is in place.

20 Contract of sale

What are typical provisions in a contract of sale?

A well-drafted contract of sale should contain, as a minimum, the following provisions:

- full name and particular of the parties. If the seller is married, the spouse must also form part of the contract;
- legal description of the property;
- purchase price and payment terms;
- obligation of the seller to deliver to the buyer at closing the documentation required for registering the purchase (certificate of title, tax receipts, etc);
- default clauses;
- date of delivery of the property; and
- representations by the parties and remedies in case of breach of contract.

The amount of down payment depends on the circumstances of the sale, especially on the time that the buyer will take possession of the property. Before delivery, payment of 10 per cent of the purchase price is common. If possession will take place from the time of signing the promise of sale, then a much higher amount might be due, up to the amount of the sale price, even if the title does not change hands. Escrows are used, but are not mandatory and not always accepted by the seller; it is normally used when a part of the payment is subject to certain conditions (delivery of title, city hall construction permits) or the payment is going to be done by several bank transfers.

21 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

Issues of environmental clean-ups in real estate transactions are still very rare in the Dominican Republic. So far, this has been a problem only in the mining sector. Therefore, there are no general covenants in use. Of course, the parties to a contract are free to insert mutually agreed terms regarding long-term environmental liability and indemnity issues.

22 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

The general recommendation for any real estate acquisition is to have the seller deliver the property without any tenants, considering the costs and duration of an eviction procedure under Dominican law. The final payment should always be made subject to such a delivery without tenants or any other type of occupation. If the buyer is interested in taking on the existing lease, the representations are extensive, starting with requesting full disclosure of the entire landlord-tenant subleases, related documents, lease receipts, etc. Leases survive a sale, but brokerage agreements do not. Requesting estoppel certificates from the tenants is not common in the Dominican Republic and the tenant is not obliged to sign them.

23 Leases and real estate security instruments

Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

In general leases are not registered at the Registry of Title and are, therefore, subordinate to a registered security instrument, such as a privilege or mortgage. However, in the unlikely case that a lease has been registered before a security interest, the terms of the lease must be respected by the creditor.

Banks usually require a first-rank mortgage and will not accept subordination to a lease. Ground or head leases are not treated differently from other commercial leases.

24 Delivery of security deposits

What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

Dominican law requires landlords to deposit mandatory security deposits (in an amount equivalent to one, two or three months of rent, depending on the term of the lease) at the government-controlled

Agricultural Bank. Any legal procedures against the tenant cannot be initiated unless such deposits have been made.

Leases commonly provide for periodic rent increases.

25 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain a zoning report or legal opinion regarding legal use and occupancy?

The typical real estate due diligence overseen by the buyer's attorney regarding title consists of the following:

- obtaining a certification from the Registry of Title stating the legal status of the property;
- obtaining a certified report from an independent surveyor confirming that the official survey coincides with the property and that there are no overlapping surveys;
- obtaining a certificate from the Internal Revenue stating that the property tax, if any, has been paid;
- confirming that the property to be purchased may be used for the purposes sought by the buyer;
- investigating if a third party is occupying the property;
- investigating the property's environmental status; and
- ensuring that the seller, especially if a corporation, has the authority to sell and can convey clear title.

As noted before, under the Torrens system, there is no need to do a chain of title searches. Title insurance is available, but is not used frequently for various reasons, especially limited protection and costs, even though the indemnity fund contemplated by the Real Estate Registration Law has not functioned properly.

The Real Estate Registration Law establishes that whoever registers first has priority over those who register after. Registration is deemed to be complete on the date the application is submitted for registration, provided the application is approved, not on the date the Registry of Title issues the corresponding certificate. Priority among different interested parties can be contractually reordered.

26 Structural and environmental reviews

Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

Structural reviews by engineers or architects can be obtained but are not very common. There is no standard procedure: it is usually the buyer and the solicitor who instruct the engineer about the scope of the review. The sales contract may establish specific representations concerning the structure and environmental issues and the corresponding sanctions in the event of a non-compliance (penalties, indemnity, right to rescind, etc), but they are not customary.

Environmental insurance is available.

It is customary to review all permits regarding existing structures or projects. Legal opinion letters are only used for internal purposes.

Any real estate project, subdivision or infrastructure must apply for and obtain environmental approval from the Ministry of the Environment and Natural Resources, pursuant to General Law on the Environment and Natural Resources 64-00, which regulates environmental pollution, the generation and control of toxic and hazardous substances, and the treatment of domestic and municipal waste, among other matters. Environmental due diligence is highly advisable for purchases of undeveloped land, as well as off-plan property purchases.

27 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

Leases are usually prepared and reviewed by lawyers. Dominican law is very protective of tenants' rights and there is no fast and efficient eviction procedure in place. Key lease issues include: lease term, tacit renewal clauses, ownership of betterments made by tenant during the lease, default clauses and waiver of certain tenant-friendly statutory provisions, clear distinction between minor and major repairs and who will be the responsible party to cover these, specific use of the property during lease term (type of business or family residency), etc.

Very often, the tenant has to find a guarantor to co-sign the lease.

28 Other agreements

What other agreements does a lawyer customarily review?

The buyer's lawyer has to carefully review any agreement regarding the property: service agreements, brokerage agreements, previous sale agreement if the price has not been paid in full and the agreements on which any registered interest is founded (easement agreements, mortgage contracts, etc).

The lawyer should also review carefully the marital status of the seller, and, if he or she is married, review any existing marriage contract. Dominican law does not generally allow the sale of any property without the consent of both spouses.

29 Closing preparations

How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

The lawyer's preparation for closing involves obtaining, reviewing or preparing the following:

- certification from the Registry of Title stating the legal status of the property;
- a certified report from an independent surveyor confirming that the official survey coincides with the property and that there are no overlapping surveys;
- a certification from the Internal Revenue stating that the property tax, if any, has been paid;
- pertinent permits or zoning reports;
- reports from engineers, if applicable;
- any agreements, receipts and discharges (services, employees, tenants, etc) related to the property;
- the identification and marital documents of the parties, and, if entities, the complete corporate documentation (by-laws, mercantile registry certification, tax ID, corporate resolution, etc);
- if the property is a condominium unit, obtaining and reviewing:
  - a copy of the condominium declaration;
  - a copy of the condominium regulations;
  - a copy of the approved construction plans;
  - certification from the condominium administration showing the seller is current with condominium dues; and
  - copies of the minutes of the last three condominium meetings;
- information as to how payment of the price of sale will be made;
- the contract of sale; and
- the closing checklist.

30 Closing formalities

Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

The closing usually takes place in the lawyer's office with all the parties present or represented by power-of-attorney. It is not necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction.

At the closing, the buyer's lawyer receives two originals of the contract of sale – one for registration purposes and the other for his or her file – and the seller's original certificate of title.

Ideally, the signing of the contract of sale, payment of the purchase price and delivery of the seller's documentation will happen simultaneously. Regarding financing, the bank usually insists on registering the mortgage first before disbursing the funds to the seller.

31 Contract breach

What are the remedies for breach of a contract to sell or finance real estate?

The purchaser can:
- enforce the sales contract (specific performance) by filing a suit at the Land Court demanding the transfer of property (the suit is automatically recorded as a lien on the property at the Registry of Title);
- ask for specific performance and damages; or
- sue to rescind the contract and obtain damages.

Similarly, the borrower can sue the bank for specific performance and damages.

32 Breach of lease terms

What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply?

Tenants can sue landlords for the specific performance of any obligation assumed by the landlord in the lease and damages. The landlord, likewise, can sue for specific performance and damages, as well as for eviction.

The customary procedure to evict a defaulting tenant is to sue in court. The process is very time-consuming for two reasons:
- before suing, the landlord is required in many cases to go through an administrative procedure that usually grants the tenant grace periods of six months or more; and
- eviction orders by lower courts are subject to appeals to two higher courts, which lengthens the process to three or more years if the tenant retains the services of a savvy lawyer.

General contract law applies to the lease, but is limited by various statutes that protect the tenants. For example, if there is no escalating clause for rent in the lease, the landlord cannot raise it unilaterally without undertaking a lengthy administrative procedure.

Financing

33 Secured lending

Discuss the types of real estate security instruments available to lenders in your jurisdiction.

Mortgages (financing from third parties) and privileges (seller's financing) are the customary security interests. Both grant the lender a registered right on the property (collateral) that can be enforced in case of default through a foreclosure process.

34 Leasehold financing

Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

There is no financing available for ground leases.

35 Form of security

What is the method of creating and perfecting a security interest in real estate?

Mortgages are created by contract between the owner and the lender, or by a tripartite agreement between seller, buyer and the lending institution. The contract is authenticated by a Dominican notary and then registered at the Registry of Titles after payment of the 2 per cent mortgage tax.

Privileges of the unpaid seller are automatic: upon review of the registration application submitted to the Registry of Titles, the registrar will register a privilege in favour of the seller if he or she can determine from the documents in the file that part of the price of sale has not been paid. The registration of the privilege is tax-exempt.

The registration of a security interest, be it a mortgage or a privilege, is perfected by filing the documentation at the Registry of Title in the jurisdiction where the property is located. The documents required for filing of a mortgage are:
- a mortgage contract;
- original of the certificate of title of the borrower;
- mortgage tax receipt; and
- certification attesting to the payment of property taxes.

For a privilege, the documents required are the same as for a sale.

36 Valuation

Are third-party real estate appraisals required by lenders for their underwriting of loans? Must appraisers have specific qualifications?

Third-party real estate appraisals are customarily required by lenders for their underwriting of loans. The appraiser, usually a surveyor or engineer, must be a recognised professional accredited by the Dominican Institute of Appraisers.

37 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

A foreign lender does not need specific authorisation to do business in the Dominican Republic. To register a mortgage in his favour, the foreign lender should obtain a local tax number. Once this tax number has been obtained, the lender is no longer subject to the general withholding taxes established for payments sent abroad (28 per cent in general, 10 per cent for interest paid to foreign financial institutions). The lender will be taxed as a permanent establishment, under the same conditions as a Dominican entity.

Regarding required documents and registration taxes, the same rules that apply for local lenders apply to foreign lenders (see question 35).

Mortgages and underlying credits can be transferred without paying additional taxes.

38 Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

Local interest rates are commonly set to the Dominican market standard rate, published on the Central Bank website. Loans can be obtained in local currency or in US dollars. Interest rates are higher than in Europe or the US and are usually fixed only for a limited time, being subject, usually, to unilateral annual review by the lender.

References to LIBOR or any other international indexes are only used in international loans.

There is no effective consumer protection in place for unreasonably high interest rates. An old usury law dating from 1919 was abolished in 2002.

39 Loan default and enforcement

How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

The remedies against a debtor in default are enforced through a specific judicial procedure at the first instance court. It is a three-step procedure, usually based on monetary default: the creditor notifies a specific demand of payment to the debtor, then files an embargo at the Registry

of Title to completely block any further registrations on the property, and then initiates the court procedure for the foreclosure, which ends in a public auction. All the rules regarding the foreclosure are of public order. Foreclosure can only be judicial; non-judicial foreclosure is prohibited by law. Defaults other than monetary defaults are possible (unauthorised distribution of dividends, unauthorised changes in the corporate structure, etc) if properly established in the loan documents and proven by the creditor.

The usual time for an ordinary foreclosure is around six to 12 months. Financial institutions benefit from an expedited procedure that takes around three to six months. In any case, dilatory procedures can be initiated by the debtor or by any other party with a registered right on the property.

Law 189-11 introduced trusts and collateral agent structures for mortgage securities as an alternative to standard mortgage-foreclosure processes, providing better protection of collateral and including an expedited foreclosure procedure.

40 Loan deficiency claims

Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

Yes. There are no limits on the amount or method of calculation of the deficiency.

41 Protection of collateral

What actions can a lender take to protect its collateral until it has possession of the property?

Throughout the foreclosure process, the debtor continues being the owner of the property until it has been sold to the highest bidder or adjudicated to the lender. Once the foreclosure procedure is begun and registered at the Registry of Titles, the property is blocked from any registration by third parties. In addition, the lender can request an injunction designating a judicial administrator. By law, the lenders also have a preferential right to collect any rent produced by the collateral during the foreclosure process. There are no risks of liability during the foreclosure process no for possession, since control of the property can only be granted if, at the end of the foreclosure process, the property is adjudicated to the creditor in case bidders do not show up or meet the minimum bid at the public auction.

42 Recourse

May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

Yes, security documents may provide for recourse to all the assets of the borrower. It is customary to insert a clause to that effect in all bank loans.

The existence of such a clause has no significance in a bankruptcy or insolvency filing. Personal recourse is not limited to actions such as bankruptcy filing, etc. The lender has a choice to foreclose on the collateral or collect from other assets of the borrower. As for guarantors, personal recourse against them is also unlimited: a special clause to that effect is customarily included in the mortgage contract.

Update and trends

A law on the conflict of laws (Law 544-14 on International Private Law) came into force in December 2014; this statute liberalised transactions involving foreigners and abolished the requirement that foreign owners of real estate be bound by Dominican inheritance rules.

A new bankruptcy and insolvency law was enacted in August 2015, effective from January 2017. It will replace the very outdated insolvency procedure in the Dominican Republic.

43 Cash management and reserves

Is it typical to require a cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

Financial institutions usually require the necessary reserves to pay taxes and insurance. For commercial loans, it is common that the financial institutions require only a segregated account but not a lock box.

44 Credit enhancements

What other types of credit enhancements are common? What about forms of guarantee?

The main method used by local banks for credit enhancement is to establish a scrutinised structure with two main elements: first, the loan is usually granted as a line of credit and any disbursement is subject to specific conditions (completion of a construction phase, obtaining of a specific permit, etc). Second, the bank is in control of a segregated account, which constitutes the only account that the borrower can use for receiving funds and making payments.

45 Loan covenants

What covenants are commonly required by the lender in loan documents?

The commonly required covenants are the following:

- prohibition from disposing of the collateral in any possible way (sale, pledging as a collateral for any other loan, etc);
- maintenance of an insurance policy in favour of the lender;
- prohibition from merging with another entity or acquiring other major assets without the approval of the lender;
- prohibition from implementing changes to the corporate structure without the approval of the lender;
- prohibition from disbursing company dividends without the approval of the lender; and
- controlling and inspection structures.

These requirements usually do not depend on the asset class, but the situation of the borrower.

46 Financial covenants

What are typical financial covenants required by lenders?

Typical financial covenants required by lenders are based on loan-to-value ratios (usually anywhere between 50:100 and 70:100), debt-service coverage ratios and financial reporting requirements. Ongoing appraisals are usually only required in specific cases.

47 Secured moveable (personal) property

What are the requirements for creation and perfection of a security interest in moveable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

The first requirement for the creation and perfection of collateral of moveable property, according to Dominican law, is always a notarised contract in Spanish that establishes or confirms the debt and describes the collateral to be pledged. Depending on the asset, there might be additional requirements, such as handing over the moveable asset to the lender and registration at the Civil Registry (regular civil pledge) or registration of an opposition at the Internal Revenue (vehicles).

Chattel mortgages, created by the Agricultural Promotion Law 6186 of 1963, are commonly used for securing machinery, inventory and other moveable assets. This type of pledge enables the debtor to keep possession of the asset while the security is in place. In the case of chattel mortgages, registration is made by filing the documents in the appropriate court.

As for aircraft, security agreements need to be drafted before a notary public and executed and filed at the Civil Registry Office and the National Institute of Civil Aviation. Securities over ships are registered at the Industry and Commerce Department.

As for intangible assets, they can be securitised as follows:

- company shares: it will depend on the type of entity (stock corporation, simplified stock corporation or LLC) and on the procedure established by the company's by-laws. In most cases, the shareholder who wishes to pledge his or her shares to a third party must notify other shareholders, directly or via the board of directors, to receive approval prior to executing a share pledge agreement and registering the pledge in the company register. All pledges over shares must also be registered at the Chamber of Commerce of the company's domicile;
- contractual rights: the execution of a pledge agreement, its notification to the contract's counterparty and registration of the notified documentation in the corresponding Civil Registry Office;
- receivables: through the execution of a pledge agreement, its notification to the corresponding debtors and registration of the notified documentation in the corresponding Civil Registry Office; and
- intellectual property: through the execution of a pledge agreement and its registration at the National Office of Intellectual Property.

48 Single purpose entity (SPE)

Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

No. SPEs do not exist in the Dominican Republic. This does not prevent an SPE from a foreign jurisdiction from registering and doing business in the Dominican Republic.

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England and Wales

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General

1 Legal system

How would you explain your jurisdiction's legal system to an investor?

The legal system in England and Wales is a common law system developed and refined through the decisions of courts and tribunals.

The majority of real estate law is governed by statute, but case law still plays an important role in determining rights and remedies.

In real estate law, contracts for the sale of land are in writing and contain details of the parties, the property, price and all other terms relied on. Oral contracts for the sale of land are usually unenforceable. In order to acquire property, there is a two-stage process whereby contracts are exchanged, at which point they become legally binding, followed by formal legal closing, which is done by way of deed.

An aggrieved party can apply to the courts for a prohibitory injunction as the courts may award equitable remedies at their discretion. The parol evidence rule, excluding verbal evidence in the interpretation of real estate contracts and deeds, applies to real estate law.

2 Land records

Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

Approximately 80 per cent of property in England and Wales (over 24 million titles) has now been registered at the Land Registry. All unregistered property is subject to compulsory registration upon certain trigger events, such as a transfer of the freehold or the grant of a lease for longer than seven years. Where a property is unregistered, third parties can record their interest in the property against the name of the landowner.

The legal interest in real property does not transfer to the transferee until the transfer has been registered at the Land Registry. In the intervening period, the property is held on trust by the transferor, for the benefit of the transferee. In addition, if a transfer is not registered within a 30-business-day priority period, it will rank below all other interests that were registered during that time.

3 Registration and recording

What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

In order to register an interest in property, the applicant must submit to the Land Registry: the deed, lease or contract creating the interest; the correct form(s); and the applicable fee. For some applications lawyers may submit certified copies of the original deeds. Depending on the type and value of the transaction, there may also be a requirement on the transferee or lessee to pay stamp duty land tax (SDLT) prior to registration.

The fees are payable by the applicant, which will often be the transferee, lessee or beneficiary of the interest.

The situation is the same for the whole of England and Wales.

4 Foreign owners and tenants

What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

There are no legal restrictions on the ownership of property by foreign nationals in England and Wales.

If a buyer or tenant of property in England and Wales is a non-resident corporation or entity, the Land Registry may require a legal opinion from an independent attorney from the relevant jurisdiction. This opinion should confirm that the corporation has the power to enter into the transaction, that its ownership of real property will be separate from the ownership of its members, and that the execution of any documents by the corporation will be valid and binding.

5 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

There are no exchange controls in place.

6 Legal liability

What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

Various liabilities arise by virtue of ownership of property, including liability for dangerous or defective land and buildings and liability to third parties for personal injury on the property.

The owner of a property can also be held liable for the environmental condition of the property, even if the contamination was the result of actions of a past owner, where the person primarily responsible for the contamination cannot be found.

In addition, the owner can have liabilities to third parties by virtue of encumbrances contained on the title to the property such as covenants restricting use.

Occupiers (being the individual or corporation in control of the property) have a duty of care towards visitors to the property. Public liability insurance can be put in place if appropriate.

If a tenant assigns its lease to a new incoming tenant, the outgoing tenant can still be liable to its landlord for performance of the obligations contained in the lease if the assignee defaults. This obligation continues for the whole of the lease term for any leases predating 1 January 1996. For leases granted after that date, a tenant's liability may continue as a guarantee of the first assignee but not for subsequent assignees.

When a landlord transfers its interest, it too can remain liable to the tenants for any post-transfer breaches of the landlord's covenants.

Lenders do not take on any property owner or occupier liabilities unless they enforce their security by foreclosing and enter onto the property, which is very rare.

7 Protection against liability

How can owners protect themselves from liability and what types of insurance can they obtain?

There are several types of insurance that owners can put in place to protect the interests of property owners and occupiers. An owner can take out buildings insurance to cover destruction or damage to the property as well as to cover the loss of rental income should such damage or destruction occur to an investment property.

In addition, an owner can obtain third party and public liability insurance to provide cover in circumstances where the owner has liabilities to third parties, for example, death of or injury to visitors to the property.

It is possible to obtain some insurance cover for environmental liabilities. However, as the cost of rectifying environmental defects is often difficult to quantify, this type of insurance can be expensive. It is not common.

If the property owner is an employer and there are employees working on the premises, employer's liability insurance can be put in place to protect the employer if an accident occurs in the workplace.

Businesses may also obtain business interruption insurance to cover the cost of moving the business to temporary accommodation in the event that premises are destroyed or damaged.

8 Choice of law

How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

Property transactions involving properties in England and Wales are governed by the law of England and Wales, whether or not this is expressly stated in the documents. The parties to a contract for sale (as opposed to the transfer or lease) of real estate in England and Wales usually choose the law of England and Wales as the governing law but can include a choice of law provision favouring another jurisdiction. A contract clause selecting a different jurisdiction would not be enforceable in the UK.

In the situation where there is a sale of a portfolio of properties within a number of jurisdictions, the relevant contract for each property is likely to be subject to the laws of the state in which the relevant properties are situated.

9 Jurisdiction

Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

England and Wales are the same jurisdiction and largely subject to the same laws, although Wales has the right to legislate differently in certain subject areas, including housing and environmental issues, so housing and environmental law in England can differ from the law in Wales, but are substantially similar at present. Scotland and Northern Ireland are subject to their own laws and practices for real estate.

Real estate lawyers are required to be qualified in the relevant jurisdiction in order to deal with real estate in that country. Lawyers preparing Land Registry documents for England and Wales are required to hold a current practising certificate from the Solicitors Regulation Authority.

10 Commercial versus residential property

How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

Under the law of England and Wales there are special protections for tenants of residential properties that do not apply to commercial tenants.

For example, tenants of residential premises have additional statutory protection relating to the management of the building by the landlord and service charge payments. Residential tenants may also have certain rights to extend their lease term or to buy the freehold (paying a premium based on value to do so). They also have a right of first refusal if a landlord wishes to sell its interest in the residential property, and rights of collective enfranchisement, which, broadly, allows tenants of a block of flats who hold leases granted for a term of over 21 years to buy the freehold of the building.

A landlord's right of forfeiture (explained further under question 32) is much more limited for residential leases.

11 Planning and land use

How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

There are strict controls on the development and use of land.

Planning permission is required from the local authority in order to carry out building works, engineering works or to change the use of the property. There are certain works and changes of use that are exempt from the need for planning permission. However, these exemptions are very limited for commercial property.

Designated conservation areas are subject to stricter regulation.

Heritage buildings (which are buildings of architectural or historic merit) are subject to even more significant controls. Even minor internal works can require listed building consent.

Demolition of buildings and structures often requires formal consent from the local authority.

Finally, all buildings must be constructed or altered in a way that complies with specific building regulations. Typically this will concern the methods and materials used in construction.

12 Government appropriation of real estate

Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

English and Welsh law allows for the compulsory acquisition of land. Compensation is usually available under complex statutory valuation procedures.

There are rights for local authorities to serve notices on owners and occupiers requiring buildings that are in a serious state of disrepair to be repaired so that they are made safe.

13 Forfeiture

Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

Parliament is sovereign and therefore laws may be passed that enable the government to acquire real estate compulsorily. Legislation is often used in relation to large infrastructure projects such as transport projects to acquire all the real estate interests required for the project. Historically, such legislation has usually included provision for compensation to be payable.

14 Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency system in your jurisdiction.

Insolvency proceedings are governed by the Insolvency Act 1986 (as amended).

Insolvency proceedings can be triggered by third parties and some may be triggered by the borrower. Administration is the process that is used to promote a rescue of some or all of the borrower's business. If invoked, there is a moratorium on any third-party enforcing rights against the company during the administration.

Other insolvency proceedings (in addition to administration and receivership) include liquidation (the corporate equivalent

of bankruptcy), company voluntary arrangements and schemes of arrangement.

Usually the start of insolvency proceedings is an event of default in a lender's security documentation.

Rent collection and distribution of rent during the insolvency proceedings will be dependent on the nature of the insolvency proceedings themselves and any priority issues between lenders.

Bankruptcy is the insolvency of an individual.

If a tenant becomes insolvent the landlord may have the right to forfeit the lease. Tenants in administration will not pay rent (unless the property continues to be used). Landlords' forfeiture rights are restricted by the moratorium.

If sellers become insolvent they no longer have the power to dispose of their property. That power will pass to the relevant insolvency practitioner (and their role depends on the nature of the insolvency). A buyer becoming insolvent between exchange and completion will usually default on the transaction leaving the seller to take any deposit paid but often without any further practical rights of redress.

Investment vehicles

15 Investment entities

What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

Recognised investment entities in England and Wales include individuals, trusts, corporations, partnerships, limited liability partnerships, real estate investment trusts (REITs) and offshore entities.

Value added tax and SDLT are potentially payable on all real estate acquisitions and disposals.

Individuals potentially pay income tax on rental income received and capital gains tax on any gain made on the disposal of the property. There may also be an inheritance tax liability on death.

A corporation incorporated in England and Wales will be liable for corporation tax on any rental income and on any chargeable gain made on disposal.

A REIT is a tax-transparent entity for investors. REITs have to comply with certain requirements. The principal company must:

- be resident in the UK;
- list its ordinary shares on the London Stock Exchange (or foreign equivalent) or be traded on a recognised stock exchange;
- not be an open-ended investment company;
- after three years of joining the REIT regime the corporation must not be a close company (other than by virtue of having certain institutional investors);
- have a single class of ordinary share capital; and
- not have any abnormal loans.

REITs have to ring-fence property investments and distribute 90 per cent of the net income profits. The property rental business has to form 75 per cent of the REIT's total income profits. Other restrictions also apply.

Offshore entities will potentially be liable to pay income tax and corporation tax on rent received, although tax on capital gains on commercial real estate may not be charged where the entity genuinely remains offshore for tax purposes. The use of offshore entities for residential real estate investment is now less tax-efficient than it was previously.

16 Foreign investors

What forms of entity do foreign investors customarily use in your jurisdiction?

Historically, the use of offshore entities was prevalent for foreign investors to avoid a capital gains tax liability being incurred on the disposal of commercial real estate. Such entities were commonly based in tax havens such as the Channel Islands, the Cayman Islands, the Isle of Man and the British Virgin Islands. The tax benefits of purchasing property using offshore entities have recently either been removed or made less attractive. The government is seeking to harmonise the tax treatment for onshore and offshore entities.

17 Organisational formalities

What are the organisational formalities for creating the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

A company formed in England and Wales must comply with the formalities for company formation and regulations for reporting and filing contained in the Companies Acts and must be registered at Companies House (the companies registry for England and Wales). Companies that completely fail to deal with reporting requirements can be struck off UK's Companies House register. Other consequences of failures to comply with corporate governance and regulatory requirements depend on the nature of the company and the breach.

Both onshore and offshore entities can be formed quickly using specialist lawyers or agents in the relevant jurisdiction.

See question 15 for the tax consequences for a foreign investor for the types of investment entity that can be used within England and Wales. Which type is most advantageous to a foreign investor depends on the investor and its circumstances.

Acquisitions and leases

18 Ownership and occupancy

Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

There are three forms of land ownership in England and Wales – freehold, leasehold and commonhold.

A freehold estate effectively gives absolute ownership of the land.

A holder of the leasehold interest has the right to possession and use of the land, for a fixed term but does not have outright ownership. The leasehold interest is granted by the owner of the freehold, as landlord, to the leaseholder (or 'tenant'). The landlord and tenant are mostly free to negotiate the terms of the lease, although there are some implied statutory protections. Depending on the terms of the lease, the tenant may assign the lease to another party, or sublet to a new 'subtenant'.

Commonhold ownership was introduced in 2004 as a new type of freehold. It relates to the freehold ownership of a single property within a larger development. It is rarely used.

Third-party rights that benefit and burden property are typically created by deed and registered at the Land Registry; however, some may be acquired by long use and can be binding on the property owner but even these need to be registered at the Land Registry to enjoy full protection.

19 Pre-contract

Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

Heads of terms are usually agreed and form the basis for the negotiation of a formal contract. The heads of terms themselves are usually unenforceable and are rarely signed or executed.

It is a matter for negotiation whether the property is taken off the market during the contract negotiations, although it is usual for the buyer or tenant to require this.

20 Contract of sale

What are typical provisions in a contract of sale?

The contract contains details of the contracting parties, the purchase price, and the amount of any deposit, the closing date and any

preconditions that need to be satisfied. Once a contract has been formally exchanged, it becomes legally binding.

If a deposit is payable it is usually between 1 and 10 per cent of the price. It is paid when the contracts are exchanged and it is usually held by the seller's lawyer on behalf of both parties pending closing.

If the transaction closes later than the set closing date, the contract usually provides for default interest to be payable.

Although the contract may deal with the investigation of title during the period between exchange and closing, it is more usual for the buyer's lawyer to have investigated the title to the buyer's satisfaction prior to exchange.

21 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

The primary liability for pollution rests with the polluter. If the original polluter cannot be found, the current owner or occupier of the property can be required by the regulatory authorities to carry out remediation works for historic contamination.

Local authorities have a statutory duty to investigate contaminated land in their area and to ensure that it is cleaned up if it is causing harm or if there is a significant risk of significant harm.

Some contracts for the sale of property will provide for the buyer to indemnify the seller in respect of any past or future liability for contaminated land. The length of the indemnity is a matter for negotiation. In some cases, a lease of property will specify liability for contaminated land, either directly or indirectly. It is a matter for negotiation on each transaction whether this is for the landlord or the tenant. If a contract or lease containing these provisions is breached, normal contract enforcement action can be taken and, if worded appropriately, the regulatory authority will be bound by the division of liability for the historic contamination in the contract.

22 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

The general principle is that the buyer must predominantly rely on its own investigations whether this is on the acquisition of a tenant's interest in a lease or on the sale of an investment property subject to leases.

It is usual for formal pre-contract enquiries to be answered by the seller's lawyers, which then form the only representations on which the buyer can rely. These enquiries will usually include representations regarding the rent and any tenant default.

Sale contracts of investment property generally leave the seller with property management responsibility up to completion but following consultation with the buyer. Tenant's works remain the tenant's responsibility following the change in the ownership of the investment. Landlord's works are almost always completed by the original contracting landlord.

23 Leases and real estate security instruments

Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

The landlord is entitled to forfeit a lease, effectively bringing it to an end, following default by the tenant. This is so even if the tenant has charged or mortgaged the leasehold interest in favour of a mortgagee. Upon forfeiture, however, the mortgagee as well as the tenant is entitled to apply to court for relief from forfeiture. In certain circumstances, the landlord may agree not to seek forfeiture of the lease without first giving the mortgagee the opportunity to remedy the breach. In the case of a ground lease, the courts are likely to allow the tenant the opportunity to remedy any breach prior to forfeiture otherwise the tenant may be deprived of a valuable asset (and the landlord receives a windfall gain) if the ground lease is forfeited for an immaterial breach.

24 Delivery of security deposits

What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

Security deposits in England and Wales in relation to leases are known as rent deposits and whether the landlord requires them will depend upon the covenant strength of the tenant and any guarantor. The amount of the rent deposit will depend on what is agreed between the parties but is commonly the equivalent of six or 12 months' rent.

Contracts for the sale of investment property deal with the transfer of any rent deposit held by the landlord from the seller as outgoing landlord to the buyer as incoming landlord.

It is unusual for tenants to give bank guarantees to landlords as security for their obligations and therefore if guarantees are given, they are specifically negotiated as there is no standard form of documentation or practice.

Rent reviews are common in commercial property leases in England and Wales. The reviews are usually every five years in an upwards direction only either to the open-market rent or to a figure calculated by reference to an inflation index. Upwards-only open-market rent reviews remain the most common rent review mechanism.

25 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain a zoning report or legal opinion regarding legal use and occupancy?

The title to the property is almost always investigated prior to exchange by the buyer's lawyers and the seller's lawyer produces evidence of the up-to-date title to the buyer's lawyer. The buyer's lawyer will investigate the title and the other matters relating to the property such as planning and local authority issues. The buyer's lawyer will usually carry out various searches and raise pre-contract enquiries of the seller's lawyer.

If the title to the property is registered at the Land Registry (as the majority are), a priority search can be made online or by post at the relevant Land Registry office to freeze the title for a period of 30 business days enabling the buyer and its lender to register its interest at the Land Registry in priority to any other pending registrable interest.

Title insurance and opinion letters as to title are not common although the insurance can be put in place to cover any specific defects in the title. Some transactions involve lawyers providing certificates of title allowing other parties to the transaction to rely on that lawyer's conclusions following the relevant title investigations.

Not all title matters are registrable at the Land Registry but there is an increasing trend towards registration in any event. In the case of registrable interests, there is priority for registered deeds over unregistered deeds.

It is customary for buyers to advise clients on the results of searches relating to the authorised use to which the property may be put for planning or zoning purposes.

26 Structural and environmental reviews

Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

Most buyers and tenants of property will usually carry out a building survey or valuation of the property (or both) and investigate the historic land uses of the property, and often follow this up with more detailed planning (zoning) and environmental investigations if necessary.

Occasionally, the seller will provide environmental information and sometimes this will be the subject of a representation or indemnity.

Environmental investigations are usually carried out pre-exchange by agreement with the seller or landlord.

Environmental insurance is available for some risks but it is relatively unusual and is costly.

27 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

Lawyers will usually review leases. The issues raised would depend upon who is being represented, the type of property and the client's business. Tenants taking leases would be expected to review the negotiated lease terms to check that they do not conflict with their business needs.

When acting for a buyer on the acquisition of an investment property, lawyers will check that the leases have been correctly executed and that the terms on which they were granted are acceptable, checking the rent review provisions and any guarantees given.

When acting for the tenant, the liabilities in the lease would usually be subject of a report to the tenant, and the longer the term of the lease the more likely it is that the lawyer will investigate the landlord's title. In addition, the lawyer should check that all consents required for the grant of the lease have been given. If an existing lease is being assigned, the lawyer should check that the landlord's consent to the assignment has been obtained.

The lender's approach to the treatment of management agreements varies from lender to lender and also depends on the type of property involved.

28 Other agreements

What other agreements does a lawyer customarily review?

The lawyers would customarily review all the title deeds, the results of the searches, replies to formal enquiries raised by them and any relevant development documentation including planning (zoning), construction contracts and warranties.

Brokerage agreements are unlikely to be reviewed by lawyers in a real estate transaction, and whether service contracts are to be reviewed will depend on the client's requirements and the type of property.

29 Closing preparations

How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

Closing of real estate transactions is often dealt with between lawyers by telephone using a professional protocol. Pre-closing searches will be carried out and arrangements finalised in relation to the discharge of any existing financial charge or mortgage.

All unregistered deeds must be collected at closing by the buyer, but where the title is registered there may be very little paperwork to hand over.

On an investment sale all of the leases and ancillary documents must be handed over to the buyer's lawyer together with an authority to collect future rents payable.

There is usually a period between exchange and closing to prepare for closing in the knowledge that the transaction is definitely proceeding. Closing is often between 10 and 20 working days after exchange, which allows time for the formal execution of documents, carrying out final searches and satisfying any conditions precedent in the loan documentation to allow closing and funding to be simultaneous.

Funders will specify what they require before the loan can be drawn down. Details depend on the property and transaction, but there will often be a significant number of conditions precedent both in relation to the status of the borrower and title to the property before drawdown can take place.

30 Closing formalities

Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

Closing is typically done by telephone by the lawyers representing the parties for the majority of transactions. The parties themselves are rarely present. There is no need for any government or licensed agent to be present.

31 Contract breach

What are the remedies for breach of a contract to sell or finance real estate?

There are common law and equitable remedies for breach of contract, and statutory protections that apply. The contract itself may have specific provisions regarding interest and compensation. Typically, under a contract for the sale of land after a trigger notice is served (called a completion notice) a buyer who fails to complete will lose its deposit and may be liable for damages and the contract comes to an end. If a seller fails to complete it will have to return the deposit along with any interest accrued, and may also be liable for damages.

Where closing occurs later than the date specified in the contract, compensation to the aggrieved party may be due in the form of interest.

It is possible to seek a court order for specific performance of the contract but the courts have discretion as to whether to order such a remedy. In England and Wales, remedies such as specific performance or injunctions are awarded at the discretion of the court.

32 Breach of lease terms

What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply?

Commercial leases typically provide for the landlord to be able to re-enter premises and end the lease prematurely, should the tenant breach the lease provisions. This right of forfeiture must be reserved by the lease, but does not require a court order in relation to commercial property. However, if the breach was of a provision other than non-payment of rent, the landlord may have to serve a notice on the tenant, giving them opportunity to remedy the breach.

For non-payment of rent, the landlord can also commence proceedings to recover the rent arrears. In certain circumstances, the landlord will have the remedy of 'commercial rent, arrears recovery'. This remedy allows a landlord to have bailiffs enter the premises and seize goods to the value of the unpaid rent after giving tenants advance notice of the intention of the landlord to seize goods for the unpaid rent.

For a breach of an obligation to repair, the landlord can, in theory, bring an action against the tenant for damages or specific performance, or carry out the repairs himself and claim for the cost. In practice, however, tenants of many leases have statutory protection against damages claims and specific performance requires the building to be in a dangerous state of disrepair.

Any tenant's claim against the landlord is likely to be governed by general contract law rather than specifically addressed in the lease.

Update and trends

The impact of Brexit on UK commercial real estate law is not yet known but it is unlikely to be significant. However, EU-derived regulations will be affected as will some of the environmental and competition laws as applied to real estate.

The UK government remains concerned about the time it takes developers to obtain planning permission for real estate developments. It is continuing to take initiatives to speed up and, where possible, simplify the planning process. Local authority planning departments are, however, following government cuts, generally somewhat under-resourced so it is not known how much difference the new initiatives will make.

There has been a body of recent case law regarding the enforceability of guarantees of tenant companies under commercial leases. As a result, on the acquisition of investment properties the guarantees given and the clauses in the leases have to be examined with greater scrutiny to make sure that the full benefit of the guarantee can be maintained for the expected duration.

Regulations are now in force to promote improved energy efficiency in commercial properties. It will be unlawful to let properties that have a low energy efficiency ratings from April 2018 and unlawful to continue with a letting of properties with the two lowest energy efficiency ratings from April 2023. There are some administratively complex temporary exclusions for landlords.

From April 2017, all UK residential property held directly or indirectly by foreign-domiciled persons will be brought into charge for UK inheritance tax purposes. This will be the case even when the property is owned through an indirect structure such as an offshore company, partnership or trust.

The government is also catching 'non-doms', who are individuals who are neither UK-domiciled nor deemed domiciled. Until April 2017 non-doms were only subject to inheritance tax on their UK assets and they could shelter their UK property by enveloping it in an offshore vehicle. From April 2017, trusts or individuals owning UK residential property through an offshore company, partnership or other opaque vehicle will pay inheritance tax on the value of the UK property in the same way as UK-domiciled individuals. This is part of the government intention to ensure that UK residential property comes within the UK tax net. In addition, non-dom status will be restricted and a non-dom who has been resident in the UK for more than 15 out of the past 20 years will be treated as deemed UK-domiciled for all tax purposes. It is not known as yet how much of an impact this will have on the sector.

Consideration is being given to the privatisation of the Land Registry, but these proposals are currently on hold.

Financing

33 Secured lending

Discuss the types of real estate security instruments available to lenders in your jurisdiction.

In relation to real estate, the most common form of security instrument is a fixed legal charge or mortgage over the property, which is perfected by deed and through registration both at the Companies Registry and the Land Registry. Often in commercial transactions a floating legal charge is created over all the assets of the business, including the real estate, which is commonly called a debenture. Legal charges do not 'convey' the property to the lender.

34 Leasehold financing

Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

Leasehold structures are well established under the laws of England and Wales and as a result financing of ground leases both on residential and commercial property is commonplace. Most residential flats in the UK will be held on a long leasehold basis rather than a freehold basis so lending institutions are very familiar with financing based on a long lease as security. Many lenders insist on a mortgage protection provision in the lease whereby the landlord must notify the mortgagee prior to taking any action for forfeiture. Lenders will rely on valuers advice as to whether a lease term is sufficient but in the residential market lenders will specify their own minimum lease terms.

35 Form of security

What is the method of creating and perfecting a security interest in real estate?

See question 33.

36 Valuation

Are third-party real estate appraisals required by lenders for their underwriting of loans? Must appraisers have specific qualifications?

This is a matter for each individual lender as appraisals are not generally compulsory in law. Usually, third-party valuations are required before a lender will complete a loan in respect of real property where a charge or mortgage is being taken as security for the loan. Lenders will often have their own panel of appraisers they draw upon for appraisals and valuations, who usually have valuation qualifications through the Royal Institution of Chartered Surveyors.

37 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

A lender outside England and Wales can obtain the same security from a borrower as a lender resident within England and Wales can. However, the lender may have to comply with the relevant financial authority's regulator's requirements for institutional lenders to carry on business within the UK.

Opinion letters from independent attorneys based in the relevant party's jurisdiction would generally be required for evidence of due execution of a mortgage or charge by an entity from another jurisdiction.

Potentially, mortgages can be assigned without paying additional tax.

38 Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

The interest rate is usually linked to the Bank of England's base rate or LIBOR plus a margin or, sometimes fixed rate loans are agreed. Arrangement fees and commitment fees are sometimes rolled into the loan depending on the terms agreed, but they will not usually be set off against any penalties payable on default.

There is no maximum rate of interest for loans. However, if the interest is too high, it may constitute a penalty that is unenforceable particularly where the rate increases following a default by the borrower.

39 Loan default and enforcement

How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

There are a number of ways a lender's remedies can be enforced. For technical reasons foreclosure is now unusual. The lender is more likely to appoint a receiver who will then act as agent for the borrower owing duties to the lender in relation to the security. However, lenders have a power to sell the property (free of any subsequent charges and

encumbrances) and do this by going into possession of the property, which may be useful where a sale with vacant possession is required.

40 Loan deficiency claims

Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

This will depend on the wording of the loan documentation and is a matter of negotiation between the parties. While some commercial loan transactions are 'non-recourse' to the borrower, most straightforward commercial and residential loan transactions entitle the lender to recover any shortfall (after the sale of the property) from the borrower and any guarantor. Usual statutory limitation periods will apply to a deficiency claim when there is such a shortfall. There is no limitation on the amounts of any deficiency claims.

41 Protection of collateral

What actions can a lender take to protect its collateral until it has possession of the property?

Lenders usually try to avoid taking possession of property because of the potential liabilities they could incur as mortgagee in possession (akin to being owner of the property). They often prefer to appoint a receiver and have power to do this by virtue of statute and under the usual terms of a legal charge or mortgage. The receiver is technically the agent of the borrower and thus his or her role is to realise the security or manage the property.

The appointment of a receiver is relatively speedy but lenders commonly have power in the mortgage to collect rents direct from tenants before doing this. To do this, notices must be served on the tenants.

42 Recourse

May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

Loans can be agreed on either a recourse or a non-recourse basis. Fixed or floating charges over the whole of the company and its assets may be required by lenders. Legal charges or mortgages over property can be accompanied by floating charges over other assets, and equitable charges over unspecified assets may also be given. Legal charges or mortgages over property can stand alone without other security. There is no typical arrangement as it is a matter for negotiation.

The security that the lender has can affect the choice of insolvency procedure adopted by the lender and whether it relates to the asset or the whole of the company. If any guarantees are given to support the security the lender may take action under the guarantee as an alternative to, or at the same time as taking action under, the primary security.

43 Cash management and reserves

Is it typical to require a cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

Cash management systems and reserves are often required in sophisticated transactions but whether they are required depends on the transaction and the creditworthiness of the borrower.

Some lenders may require that rental income from an investment property be paid directly to them.

44 Credit enhancements

What other types of credit enhancements are common? What about forms of guarantee?

Letters of credit, holdbacks and guarantees can all be utilised in real estate transactions, but whether they are depends on the type and sophistication of the transaction, the loan-to-value ratio, the type of security being offered and the covenant strength of the borrower. On straightforward acquisitions and disposals completion guarantees are unusual, but a system of binding undertakings are used to ensure that post-completion formalities are dealt with.

45 Loan covenants

What covenants are commonly required by the lender in loan documents?

Commonly used covenants (in addition to financial covenants) in relation to the property are undertakings given by the borrower to repair and maintain the property, to insure it, to comply with all relevant legislation and to manage the property and provide occupational lease management, and will often incorporate restrictions on subletting and carrying out alterations without the consent of the lender. The majority of loan covenants are similar regardless of the use of the property, although there may be specific additional covenants that relate to the use to which the real estate asset is put.

46 Financial covenants

What are typical financial covenants required by lenders?

This will depend on the type of loan but in relation to non-recourse loans, typical financial covenants would include a loan-to-value ratio (the ratio between the size of the outstanding loan and the value of the security), an interest cover ratio (the ratio of the rental income to the

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interest payable) and a debt service ratio (the ratio of rental income to total debt repayments). It would be usual for the lender to have the right to call for financial reporting and to have the right to require that valuations are carried out to check compliance.

47 Secured moveable (personal) property

What are the requirements for creation and perfection of a security interest in moveable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

A fixed or floating legal charge must be created by deed and registered at the Companies Registry. Assignments of the right to receive rent or to charge bank accounts are potentially registrable at the Companies Registry and notice of the assignment must be given to the payer in order to perfect the security.

48 Single purpose entity (SPE)

Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

There is no requirement by lenders that a borrower should be an SPE. Many borrowers choose to use SPEs for project-specific transparency and to ensure non-recourse liability. SPE corporate structures can be used to promote tax-efficient investment in properties.

All UK companies need at least one director. The existence of an independent director is not linked to the procedures for insolvency filing.

France

Alfred Fink
Taylor Wessing

General

1 Legal system

How would you explain your jurisdiction's legal system to an investor?

The French legal system is a civil code system. The body of civil law is composed of written law (whether national or EU) and (to a limited extent) legal custom, as construed by the French courts (case law, but there is no stare decisis rule).

French contract law varies, to some extent, according to the commercial or civil nature of the agreement. All contracts may be concluded either orally or in writing. Oral agreements are generally valid without the need for any formality, unless otherwise provided by law. Oral evidence is generally not admissible to alter or challenge the content of any written contract.

2 Land records

Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

The entire French territory is registered in the form of numbered plots of land in the cadastre. It is the basis of the Land Registry, in which ownership, long-term leaseholds and mortgages are registered. Any right on immoveable property will be attached to a numbered plot of land. Any registration or modification of the Land Registry requires a notarised deed (eg, the title transfer deed or a long-term (commercial) lease agreement (exceeding 12 years), emphyteutic or construction leases or a mortgage). The notarised deed is effective between the contracting parties as of its execution before a notary public.

Interests must be registered since they become effective towards third parties only with registration in the Land Registry.

3 Registration and recording

What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

The registration of a title transfer, (long-term) lease or mortgage requires a notarised deed and the upfront payment of the registration costs to a French notary public. A notary public is a civil servant in private practice. The Ministry of Justice nominates the notary public and allocates an available office to him or her (as there are a limited number of offices in France, although the Macron Law dated 6 August 2015 allowed the creation of additional offices in specific rural areas). The law organising the Land Registry is applicable to the entire French territory; however, there are some particular features in Alsace and Moselle, Mayotte, French Polynesia and New Caledonia.

4 Foreign owners and tenants

What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

Foreign-registered or foreign-controlled entities can own or lease French property without particular restrictions. A foreign investor should be aware of the following general mandatory notification obligations:

- real estate investments (sale and purchase) exceeding €15 million must be notified to the French central bank for statistical purposes; and
- foreign entities holding French property are generally subject to a 3 per cent annual tax on the fair market value of their property, except if they disclose their shareholders; the disclosure obligation applies to the entire chain of companies up to the final beneficiary (ie, a natural person or a listed company).

5 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

There are no French exchange control issues. However, laws and regulations concerning foreign-exchange control require that the transfer of funds must be managed by an accredited financial intermediary. In addition, some administrative formalities must be completed in the case of investment in French construction companies raising buildings available for sale or rental purposes.

6 Legal liability

What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

Property owners incur civil liability if, for example, their property causes a nuisance to a third party (such as neighbours), bearing in mind that many commercial leases stipulate exemptions that are subject to dispute. They may also incur administrative or criminal liability in the case of certain violations (eg, erection of a building in violation of planning regulations, infringement of environmental legislation, polluted soil and waste).

Property owners bear real estate taxes (eg, land tax, taxes on offices, municipal taxes, town planning contributions) even if these taxes may be charged to the tenants in accordance with the commercial lease provisions, as well as obligations and liabilities arising from public easements and co-ownership (and associated service charges).

A tenant incurs contractual liability towards the owner if it does not comply with its contractual obligations. In addition, a tenant incurs tort liability towards third parties if its actions are a cause of nuisance. The owner is entitled to call the tenant to account for its actions if the third party pursues the owner instead of the tenant.

A lender will not face real estate liability if it is only making funds available to a person for the acquisition of a property.

After the sale of a property, the seller may be liable to the purchaser in accordance with the provisions of the sale agreement and under

statutory law (such as legal warranties for defects in quality or for the non-disclosure of mandatory information about the energy consumption of the building, the geological situation of the plot of land, etc). To some extent, the seller may limit such warranties contractually, but only if he or she is a non-professional seller and if these warranties are not mandatory, such as an eviction warranty or a warranty over the surface area of co-ownership lots. On this basis, the seller is liable not only to the direct purchaser but also to subsequent owners. Specific provisions also exist in construction law.

7 Protection against liability

How can owners protect themselves from liability and what types of insurance can they obtain?

Property owners subscribe to insurance policies covering damages that might affect, or be caused, by the building. In a due diligence, a lawyer regularly checks the maximum insurance coverage, the loss of rent cover and the contractual disclaimers, and verifies whether the building is insured for its reconstruction value 'as new'.

In addition, the law requires the tenant of a residential lease to take out insurance policies covering damage for which it could be held accountable (the insurance policy must at least cover the building against damage caused by fire, explosions and water). All commercial leases contain similar contractual provisions protecting the owner and its property.

When the target property has been in existence for less than 10 years, it is also important to check the validity of the construction insurance policies (ie, 10-year liability insurance policy, damage insurance policy), which can be capped for commercial buildings under certain circumstances.

8 Choice of law

How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

French courts apply the lex rei sitae rule. In an asset deal, the French notary public will draft the deed of transfer in accordance with French law and in the French language, while the parties in a share deal have, in principle, a choice of law. Lawyers generally draft the share purchase agreement (SPA) including the choice of law and a language provision; the parties agree to execute a summary version of the SPA in French for registration with the French tax administration. Parties to a share purchase agreement regarding a foreign real estate company holding French real estate must reiterate the transaction before a French notary so that the French notary can make sure that French transfer taxes on the transaction have been paid.

A pan-European portfolio can be sold under a framework agreement covering the entire transaction, but it requires a separate execution agreement under the law of the jurisdiction in which the respective property is located.

9 Jurisdiction

Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

The French court system is divided into two separate subsets, judicial courts and administrative courts. Each has two levels, courts of first instance and courts of appeal, which examine or re-examine both questions of facts and law. In the judicial court system, the courts of first instance are the Tribunal de Grande Instance, which has jurisdiction over all matters (in particular, commercial leases and real property matters), except those coming within the exclusive jurisdiction of specialised courts by reason of the amount involved or the subject matter of the case; the Tribunal d'Instance, which has jurisdiction over small civil claims and exclusive jurisdiction over certain matters, such as residential leases; and the Tribunal de Commerce, which has jurisdiction over commercial matters including insolvency proceedings, except those coming within the exclusive jurisdiction of specialised courts by reason of the amount involved or the subject matter of the case.

The Cour de Cassation is the supreme court of the judicial system.

Administrative courts are competent for most of the matters within the scope of urban planning law and environmental law (although judicial courts may deal with some litigation aspects of polluted sites).

The Conseil d'État is the supreme court of the administrative court system.

All actions are initiated by service of summons or joint petition at the clerk's office, except before the commercial courts and the tribunaux d'instance where a simple petition or a declaration at the court registration may be sufficient regarding the matter involved and the amount in dispute; the initiative can be taken by a foreigner without any business activity in France. Where a French plaintiff wishes to serve a summons on a non-resident defendant, EU Regulation (EC) No. 1393/2007 applies if the defendant is a resident of an EU member state (with limited exceptions), and in most other cases the Hague Service Convention of 15 November 1965 (service of documents) applies and the time taken may increase (specifically after a writ of summons and notification of the decision).

10 Commercial versus residential property

How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

From a Civil Code perspective, the same law applies irrespective of whether the property is in commercial or residential use, while a special set of rules of the Commercial Code and a special law of 6 July 1989 complement the civil law system for commercial lease agreements and residential lease agreements respectively.

A commercial lease has a mandatory duration of nine years but provides the tenant with a break option after the third and the sixth year (meaning that the tenant can terminate the lease without cause). If the lease is entered into for office use, single-use premises or if the lease duration exceeds nine years, the tenant may waive its break options in exchange for a rent-free period or a financial contribution to the fitting-out costs of the premises. At the expiry of the lease, the law provides for a formal procedure that the parties must respect in the case of continuation or discontinuation of the lease agreement. In this regard, a commercial lease is perceived as tenant-friendly. In 2014, the Loi Pinel (Law No. 2014-626 of 18 June 2014) brought a number of modifications for commercial leases and reinforced the situation with regard to recoverable charges and taxes, especially for the landlord.

A residential lease (unfurnished) is concluded for period of at least three years if the landlord is an individual and six years if a legal entity. The tenant can terminate the lease giving one month's notice in dense zones such as Paris and its suburbs, and three month's notice in other areas). In cases where neither party has served a termination notice, the lease is tacitly renewed for the same duration. It is more difficult for the landlord to give notice since he or she has to respect a six months' notice period prior to the expiry of the lease and must justify his or her decision on one of the following grounds:

- selling the premises;
- living in the premises (or have the premises occupied by a close relative); or
- for a serious and legitimate reason (which is rarely admitted).

A furnished apartment can be leased only for a period of at least a year, while for student accommodation the minimum lease term is nine months.

The legal framework of residential leases is perceived as being tenant-friendly.

11 Planning and land use

How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

Development, construction and use of real estate must comply with a set of planning and land-use rules from all levels of French administration (state, regions, departments and cities).

For instance, one of the main documents prepared by each city is the local urbanism plan (PLU) (formerly known as the land-use plan (POS)), which divides the area into zones of different uses and attribute building density ratios to each zone. The state's regional representative controls the legality of local land-use plans and influences their preparation through specialised departments of the regional and national administration.

Each construction or planning operation is subject to authorisations such as planning permits and building permits or prior declarations for construction. Such authorisations are granted by cities and may require opinions from various authorities regarding the activity under consideration, which often increases the review period.

12 Government appropriation of real estate

Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

The legal regime is set in the Compulsory Purchase Code. In accordance with its stipulations, a compulsory purchase of real estate is only possible if the public interest justifies such an action and only public-law entities (the state, local governments or public services companies) can make use of this regulation.

Owners will be compensated. The expropriator proposes a compensation package based on the market value of the real estate and the cost of the procurement of a similar property. In case of disagreement between the owner and expropriator on the compensation package, the owner is entitled to introduce litigation asking a judge to determine fair compensation and the opposing party has a period of six weeks following the notification of the plaintiff's brief to file a response.

Tenants are also entitled to compensation. They also have a right to demand resettlement.

13 Forfeiture

Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

The Penal Code provides provisions enabling a judge to forfeit real estate, as a complementary sentence, and without compensation, for all crimes and serious offences punishable by at least one year of imprisonment (article 131-21 of the Penal Code). A judge can also decide to affix seals on buildings for the period of time necessary for the investigations.

14 Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency system in your jurisdiction.

French law distinguishes pre-insolvency and insolvency proceedings:

The pre-insolvency proceedings are the special mediation and conciliation procedure and the safeguard proceedings, which can only be initiated by the debtor or the management of the debtor company. In the following, we focus on safeguard proceedings. The management of a debtor company is entitled to file a petition to open reorganisation proceedings (safeguard proceedings) as long as it is solvent and experiences difficulties that it cannot overcome by itself. The judgment commencing safeguard proceedings opens a six-month observation period during which the company will negotiate a rescheduling or waiver of the debts in the framework of a safeguard plan with its creditors. The court will appoint a judicial administrator to supervise or assist the debtor company's management in the drawing up of the safeguard plan and a creditors' representative in charge of collecting statements of claims and verifying the debtor's liabilities. Creditor committees are also entitled to present their own alternative safeguard plan. During the observation period, the debtor company enjoys a stay of payments and proceedings. In addition, an accelerated (financial) safeguard procedure exists resolving the practical issue that, in the general framework of conciliation, the unanimous consent of creditors is necessary for a moratorium. The debtor may directly move from conciliation to the accelerated safeguard procedure when it proves to the court that the restructuring plan has a good chance of being approved within a short timeframe by a two-thirds majority of creditors in their respective committees.

The insolvency proceedings are the rehabilitation proceedings and the liquidation procedure, during which the debtor company enjoys a stay of payments and proceedings:

Rehabilitation proceedings

A debtor company that is insolvent must apply for the opening of insolvency proceedings within 45 days of the occurrence of insolvency, unless it has requested the appointment of a conciliator or the opening of liquidation proceedings. (A company is insolvent if it is not in the position to meet debts due and payable with liquid assets – 'cash-flow insolvency test'). If the court considers that the business may be continued as a going concern, it will order a two-month observation period that can be extended up to a total maximum period of 18 months during which a court-appointed judicial administrator will investigate the affairs of the debtor and make proposals for the reorganisation of its business. At the end of the observation period, the court will issue an order either to continue the debtor's operations by way of reorganisation or to sell its assets to a third-party purchaser as a going concern by way of a sale plan (the creditor committees are entitled to present their own alternative reorganisation plan, which will compete with the plan of the debtor company).

It is noteworthy that since August 2015 French law allows the forced eviction of shareholders of a company in rehabilitation proceedings, either through a forced sale or by a dilution of their shareholding. If the general shareholders' meeting rejects a rehabilitation plan that provides for a share capital increase in favour of a third party, the administrator can ask the court to either appoint a nominee who can vote in favour of the plan in the place of the opposing shareholder or order the forced sale of the shares of the opposing shareholder to the third party who committed to comply with the rehabilitation plan.

Liquidation proceedings

If the court orders the liquidation of the debtor's assets, a liquidator is appointed and the debtor is divested of all rights pertaining to the disposal of assets. The role of the liquidator is to collect and liquidate all the debtor's assets with a view to maximising proceeds. The debtor's business can be sold as a whole or in part in the framework of a sale plan, or its assets may be sold on a piecemeal basis either at public auction or by private sale.

Investment vehicles

15 Investment entities

What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

France generally recognises foreign entities that have legal personality in their home country. The company and its executive manager may act only within the limits of the applicable home-country corporate law. There are no entities that allow the avoidance of transaction taxes. The most commonly used corporate tax transparent entities are the real estate partnership (SCI) and the commercial partnership (SNC). Investors must be aware that the liability of shareholders in these two forms of company is unlimited (unlimited several and pro rata liability in an SCI; and unlimited joint and several liability in an SNC). The investor's best shield against corporate liability in France is a limited liability company (SARL) or a simplified joint-stock company (SAS). There are French-regulated real estate investment companies (SCPIs), listed companies comparable to real estate investment trusts (REITs) (called SIICs) and open-ended investment funds (OPCIs). The SCIs

and the SNCs can be treated as partnerships for tax purposes (and are mainly treated as (semi-)tax-transparent entities), while SIICs and OPCIs have a special tax-exemption regime.

16 Foreign investors

What forms of entity do foreign investors customarily use in your jurisdiction?

Foreign investors hold their properties directly or indirectly through a French company (SAS, SARL or SCI) or an OPCI. Some structure their indirect investments in property through Luxembourg and the Netherlands. French tax authorities are likely to challenge these structures when they are mainly tax-driven and the substance of the foreign entity is doubtful.

Most of time investors will prefer to structure their investments through a French limited liability company (SAS, SARL or SA) and most often chose a SAS (simplified joint stock company) owing to its flexibility.

France recently executed an amendment to its double taxation conventions with Luxembourg and with Germany. In both cases, the new provisions significantly alter the applicable tax regime on capital gains deriving from the disposal of shares, units or other rights in a company, whose assets or property are made up of more than 50 per cent of their value or hold more than 50 per cent of their value in real estate. The new rules give the right of taxation to the state in which the real property is situated. Some foreign investors have even chosen the OPCI structure, which is advantageous for the investor as long as it receives dividends under the ordinary rule of the Double Taxation Convention.

17 Organisational formalities

What are the organisational formalities for creating the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

The creation of a French company generally requires the following steps:

- drafting of articles of incorporation;
- depositing the subscribed capital in a (blocked) bank account;
- where required by law (depending on the type of company or a set of particular thresholds), appointment of a statutory auditor;
- appointment of the first managing director;
- completing a declaration for a foreign individual doing business in France;
- resolution of the foreign company to create a foreign subsidiary; and
- where relevant, listing on the stock exchange or approval of the regulatory body.

If these steps are not completed, the registration will be rejected by the French Commercial Court.

The tax consequences in the use of a particular type of entity are the following:

- tax-transparent entities: the taxation occurs at the level of the investor whether or not the profit is distributed;
- corporate entities: the taxation occurs at the level of the company (the investor may be subject to withholding tax in France upon distribution of profits);
- regulated entities (SIICs, OPCIs and FPIs) are totally or partially exempt from corporate income tax, subject to conditions (eg, distribution requirements); and
- a withholding tax is, in principle, applicable on distributions to foreign investors and similarly, capital gains realised upon disposal of shares or units may be subject to withholding tax.

The most advantageous type of entity, from a tax viewpoint, will depend on the particular situation of the investor.

Acquisitions and leases

18 Ownership and occupancy

Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

The basic legal ownership right is full ownership. Full ownership can be divided into two real property rights: usufruct (right of enjoyment, enabling a holder to derive profit or benefit from property) and bare ownership (full ownership without usufruct).

Long-term leases (such as construction or emphyteutic leases), granted for a minimum duration of 18 years, grant a real property right to the tenant, which means he or she will become the owner of any construction on the plot of land, existing or to be built, during the term of the long-term lease, without being the landowner. The tenant is able to grant a mortgage on the building in his or her ownership to a credit institution.

Any burden on a property (rights of way, easements, air rights, access, etc) is generally established by a notarised deed. Nevertheless, there may also be some public easements that have not been registered and need some research, particularly in rural areas (eg, in the case of a wind farm).

19 Pre-contract

Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

It is customary to execute letters of intent that include a 'non-binding' or 'subject to contract' provision, bearing in mind, however, that the concept of a 'non-binding agreement' does not exist under French law (but an obligation may be undertaken, subject to conditions precedent or subsequent, provided that an obligation may not be subject to a condition that is fully within the control of the obligor). Accordingly, a French court can interpret a 'non-binding' agreement as binding (or conversely) and order the enforcement of the agreement if the court considers that the parties have agreed on the main items of a transaction (particularly parties, object and price). Special attention must therefore be given to the drafting of letters of intent: the practice recommends providing an offer for a limited period of time and excluding any commitment from the parties before the signing of a preliminary contract prepared by their respective legal advisers (see also question 20).

Pre-contractual negotiations fall principally under the scope of freedom of contract. The parties must, however, comply with the principle of good faith and the reinforced disclosure duty (meaning that each party must disclose to the respective other party any fact or information being of decisive importance for its agreement to the contract (articles 1104 and 1112-1 of the new Civil Code).

A contract concluded in breach of the rights of the beneficiary of a pre-emption agreement or a unilateral promise by a third party aware of those pre-contractual agreements would be void.

It is customary to take the property off the market while the negotiation of a contract is ongoing since the purchaser regularly requires exclusivity during the negotiation of the agreement. (Be aware that the undue termination of negotiations may result in a claim for damages by the other party.)

20 Contract of sale

What are typical provisions in a contract of sale?

The deed of transfer is customarily preceded by a preliminary contract of sale, which, although already binding on the parties, is subject to conditions precedent (usually, the preliminary contract itself follows after a letter of intent – see question 19). A technical audit file gathering various documents relating to safety, energy efficiency audit of the

building and health of the occupants is appended to this preliminary contract (see also question 26).

Under the preliminary contract, the purchaser generally pays an amount of 5 to 10 per cent of the purchase price into an escrow account ('earnest money deposit'). This payment will either be regarded as a down payment if the deed of transfer is executed or as a contractual penalty in favour of the seller if the deed of transfer is not executed owing to a default on the part of the purchaser. In all other situations, the deposit is returned to the purchaser.

When this contract takes the form of a private call option agreement, the beneficiary must file it with the tax authorities within 10 days of its execution in order to maintain its legal validity (which triggers nominal registration fees).

The deed of transfer consists of two sections:

- the standardised section, which contains the mandatory provisions for Land Registry filing, in particular the description of the participating parties and their respective capacity, the description of the property (including cadastral references, the vendor's immediate root of title, the mortgages, charges, easements and all other interests in land created by operation of law or by contract), and specifying the transfer date, the purchase price and the taxes falling due upon completion of the transaction; and
- the freely negotiated section describing the due diligence process and containing the seller's representations and warranties (especially with respect to the planning, environmental, technical and rental situation of the property), the 30-year root of title, and miscellaneous provisions.

Prior to the notarisation of the deed of transfer, the purchaser must wire to its notary the whole (or residual part) of the purchase price, notarial fees and taxes triggered by the transaction. Upon execution of the deed of transfer, the notary public will, under his professional responsibility, apply the amount received to its required uses (repayment of mortgagees, if any, payment of duties and taxes, payment to the seller, etc) (see questions 24 and 29).

21 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

The seller of an industrial site on which it undertook a regulated activity (ie, activity submitted to an authorisation (ICPE) or registration obligation) must comply strictly with article L514-20 of the Environmental Code. The seller must disclose in writing to the purchaser the known risks or issues arising from the operation of the activity (pollution, for instance). In the case of an information default, the purchaser may demand the cancellation of the sale or the restoration of the site at the seller's expense when such action does not seem out of proportion in relation to the purchase price. In the absence thereof and if any pollution established makes the land unfit for the use provided for in the contract within two years of the pollution being discovered, the same sanctions as above apply.

The operator of a regulated plant is liable for cleaning up when leaving or closing down the plant. Hence, the cleaning obligation is incumbent on the last operator of a regulated plant and not on the landowner (but the landowner's liability could be sought on the legal ground of the waste regulations or if the last operator did not comply with its obligations). It is noteworthy that a decree now specifies the conditions under which a third party can file a demand to the administrative authority to substitute the last operator in its administrative obligations to comply with the decontamination obligation. This substitution is subject to the technical and financial capacities of the third party who should constitute financial guarantees; the operator will remain subsidiary liable in case of default of the third party.

In addition to the mandatory representations and warranties (such as the mandatory representations required under articles L514-20 and L125-5 of the Environmental Code, or the regulations relating to asbestos, termites, technological and natural risks, etc), the seller usually represents and warrants as to the absence of pollution or hazardous materials in the property and as to the findings of the mandatory surveys (eg, concerning asbestos) and the optional surveys (eg, concerning pollution). See question 26.

In cases of latent land pollution, the purchaser will have a remedy against the seller if the legal liability for latent defects applies to the sale or if the seller has granted the purchaser a specific environmental guarantee or misrepresented the absence of any pollution.

Clauses regarding long-term environmental liability and indemnity are uncommon. Nevertheless, regarding the Reform of the Law of Contract, the General Regime of Obligations, and Proof of Obligations (Ordonnance No. 2016-131 dated 10 February 2016), and more specifically provision 1195 of the new Civil Code, the parties may be led to stipulate such clauses within commercial leases owing to the power entrusted to judges in the case of unpredictable change of circumstances.

22 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

The seller shall, in particular, represent that leases are legally binding and, unless specified otherwise, that the rent was not modified, that the tenants are not in breach of their obligations under the leases and that no tenant has issued a lease termination notice (a tenant estoppel certificate does not exist). The representations also provide that the landlord has complied with all its obligations under the leases (in particular in relation to works and delivery obligations).

In the preliminary contract, the seller represents that between the preliminary contract date and the closing date (ie, the date of the deed of transfer) the seller will neither amend nor terminate existing leases nor sign any new leases, except with the purchaser's prior consent and that the seller communicates any termination letter received from one of the tenants.

The preliminary contract and the deed of transfer also contain a provision concerning payment of the brokerage fees.

23 Leases and real estate security instruments

Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

The interaction between leases and security instruments is exclusively governed by law so that leases (except ground leases) do not contain stipulations regarding the priority over security instruments.

Where a lease satisfies the conditions required for it to be binding as against third parties, the tenant is entitled to oppose its rights under the lease to the holder of a security instrument or to the new owner of the property, at least for a certain period of time after foreclosure.

Pursuant to article 2199 of the Civil Code, any lease granted by the debtor after the filing of the seizure order, whatever its term, is not binding as against the beneficiary of the foreclosure or on the purchaser. However, the lease's precedence may be proved by any means. For example, if the lease was signed as a notarial agreement, an original copy of the lease has been filed with a local tax registry or the lease was properly referred to in a notarial agreement prior to the filing of the seizure order with the Land Registry.

Loans are granted on the basis of the rental situation at their inception. However, loans contain covenants under which the borrower commits to comply with certain requirements regarding lease management or in the event that the property is relet in whole or part. Notably, in order to ensure that the property will be properly managed, the lenders may require the borrowers' property managers to execute a duty of care letter with them.

24 Delivery of security deposits

What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

Security deposits are standard market practice in all types of leases. Regarding commercial leases, the landlord may, in lieu of a security deposit, accept either joint and several guarantees or a first-demand bank guarantee (eg, a standby letter of credit). The lawyers and the notary public involved in the transaction will check whether the lease provides the landlord with the right to transfer the cash rental deposit to the buyer or if the tenant consents to such transfer (bearing in mind that if the tenant refuses such transfer the seller will have to reimburse the cash deposit). They will also check the provisions of the above-mentioned guarantees (in particular the first-demand bank guarantee) in order to determine whether these (bank) securities may be transferred to the purchaser upon execution of the final agreement.

The law provides for public policy statutory and contractual rent reassessment mechanisms. In practice, the parties agree on periodic rent reviews by indexation.

25 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain a zoning report or legal opinion regarding legal use and occupancy?

The notary public generally undertakes and assumes the responsibility for the title search, since he must include evidence of a 30-year uninterrupted root of title in the deed of transfer. He is liable towards his client and must ensure that the final agreements are valid, binding and not capable of being challenged. In addition, the notary must take out an insurance policy that guarantees his liability. The professional body governing all French notaries established a captive insurance company that guarantees the liability of all French notaries. It is uncommon to ask for title insurance.

In relation to the conveyance of one and the same property, French law gives priority to the deed of transfer that was first filed at the Land Registry.

It is market practice that the notary public includes in the deeds confirmation that the legal use and occupancy of the target asset comply with the applicable town planning documentation. A zoning report will be provided on only explicit request.

26 Structural and environmental reviews

Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

Under French law, the seller must provide the purchaser of real property with a large number of engineering and environmental surveys or certificates relating to asbestos, termites, energy performance (including environmental appendix in the case of office spaces exceeding 2,000 square metres). If the property is located in an area known for natural, mining or technological risks, environmental reports and, for residential premises, confirmation of lead levels and compliance of gas and electricity fittings and inspection of the non-collective sewerage facilities are required in addition. The provision of most of these certificates is mandatory. Some surveys and certificates remain optional (such as legionella, except for public-access building with hot water for sanitary use, radon except for some public-access building in specific areas, pollution except for authorised business activities (ICPE) environmental certifications), but their provision has become market practice. Engineering reviews are still optional, but the seller often undertakes such reviews in order to be able to limit liability.

In addition, the seller has mandatory information obligations, compliance with which is controlled by the notary public. The reform of the law of obligations has generally reinforced the information obligation between contracting parties. Environmental insurance is available.

27 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

The review of leases is generally undertaken by lawyers, who verify whether each lease was validly entered into and further examine the term and rent provisions, the possibilities of termination, periodic rent reset mechanisms, provisions relating to service charges, taxes and works, provisions in respect of subletting, transfer of lease and other specific clauses such as indexation and limitation of liability provisions, specifically regarding the new provisions resulting from the Reform of the Law of Contract, the General Regime of Obligations, and Proof of Obligations (Ordonnance No. 2016-131 dated 10 February 2016). Areas of focus include any potential invalidity of the lease (or of specific covenants) and clauses having a financial impact (rent-free period, major works or service charges that cannot be recovered from the tenant, commitment of the landlord to finance refurbishing works, etc). The Loi Pinel and its implementing decree limit the number of recoverable service charges and taxes under a commercial lease agreement for leases executed or renewed after 1 September 2014 or after 5 November 2014 depending on the provisions. Hence lawyers will particularly review the rental charges (after the application decree, ie, after 5 November 2014). This review will also include the environmental schedule appended to commercial leases for office space exceeding 2,000 square metres, which will in particular contain information and the tenant's obligations regarding energy use.

The commercial aspects of leases are generally reviewed by the buyer's business adviser (eg, asset manager).

In a share deal, the review of property management agreements is usually undertaken by the buyer's business adviser. When undertaking a property financing, the bank's lawyer will review the property management agreement considering that this agreement is subject to the lenders' prior approval. The lender would like to ensure that the property manager will comply with its obligation under this agreement and requires the execution of a duty of care letter between the lender and the manager.

28 Other agreements

What other agreements does a lawyer customarily review?

Within the context of a share deal (and only exceptionally in asset deals) lawyers customarily review service agreements (such as asset, property and facility management agreements), tax situation and insurance policies. Agreements for the marketing of the property to tenants are generally not within the scope of such reviews, unless the seller is prepared to grant a rental guarantee (see question 22).

29 Closing preparations

How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

Documents customarily requested at closing are those that verify the following:

- legal capacity of the contractual parties (by-laws, excerpt from the company register, non-bankruptcy certificate, power of attorney, capacity opinion from a law firm, etc, or equivalent documents for non-French entities);
- compliance with French money laundering regulations;
- waiver or expiry of the pre-emption right of the relevant municipality in respect of the property and, when applicable, of the right of pre-emption of the tenant or tenants for residential premises (or rural land);
- an excerpt from the Land Registry confirming the title and the absence of encumbrances over the property, such excerpt to be dated less than two months prior to the closing date and covering a 30-year period;
- copies of all transfer deeds over a 30-year period;
- original copies of the leases and of the guarantees related to the leases;

- compliance of the property with technical and environmental requirements (certificates referred to in questions 20 and 26) and with environmental documentation in respect of the operation of a classified facility on the property sold (eg, authorisations, registration orders, declarations, formal notices from the prefect, etc);
- compliance of the property (and, as the case may be, the development project contemplated in relation thereto) with urban planning and construction rules (such as the delivery of an unchallengeable building permit);
- co-ownership/volumes/AFUL (town landowners' association) documents – as regards AFUL, the checking will concern its legal capacity by obtaining documents evidencing that the relevant publication formalities have been carried out;
- tax documentation;
- evidence of insurance policies and payment of insurance premiums, such as multi-risk insurance and construction insurance (see also question 7); and
- any other item resulting from the negotiations.

The apportionment of land tax, the lease rentals and service charges among the seller and the purchaser is customarily done on a pro rata temporis basis.

The execution and closing of the title deed is done on the same day together with the payment of the purchase price, which means that the acquisition finance (funding) must be in place on that day.

30 Closing formalities

Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

In an asset deal, the closing takes place in the office of the notary public in the presence of the seller and the purchaser (in person or represented). The transfer of ownership materialises when – after the notary has verified their identity – the parties execute the title transfer deed. In the following, the notary is charged to undertake all formalities to register the change in ownership with the Land Registry.

31 Contract breach

What are the remedies for breach of a contract to sell or finance real estate?

This situation may occur if and when a (conditional) pre-contract has been signed and the parties must meet for the final closing at the notary office. Assuming that one party does not come to the final closing, the notary will establish a document about its absence or the party present will demand a bailiff to come to the notary office in order to prepare a report on the situation. These documents constitute a proof that will allow the party present to oblige the missing party to execute its obligation under the pre-contract or to claim damages for the no-show of the other party in court.

With respect to a loan, as a general matter, upon the other party's default neither a lender nor a borrower is typically entitled to sue for specific performance of a binding loan commitment, but is entitled to sue for damages or termination of the loan in the worst case scenario.

32 Breach of lease terms

What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply?

In the case of a breach of contract, the respective contractual party can claim damages or introduce a court procedure with the purpose of rescinding the commercial lease agreement owing to breach of the lease terms. The decision about whether the breach of the lease terms is significant and justifies rescission of the commercial lease (eg, non-payment of rent) lies within the judge's discretion. For lease agreements entered into on or after 1 October 2016 and unless otherwise provided, one party may now be able to refuse to perform its obligation if the other party is or will be in performance default, should such non-performance be sufficiently serious without having recourse to the courts (articles 1219 and 1220 of the new Civil Code).

Commercial lease agreements often foresee a clause according to which any breach of lease terms permits the landlord to rescind the agreement (rescission clause). The landlord must (formally) notify the breach of contract to the tenant. The notification must explicitly define the breach, provide for one month's grace period to remedy the breach and indicate that the landlord will rescind the commercial lease if the breach continues after the expiry of the grace period. Assuming that the tenant does not remedy the breach, the commercial lease is rescinded. The landlord may apply for a summary judgment that provides him or her with an executory title to evict the tenant. The judge will determine whether the conditions of the rescission clause have been met, especially regarding payment default. In such a situation the judge is nevertheless entitled to grant delays to the debtor in order for it to pay its debts (which cannot exceed 24 months). The judge is normally not entitled to apply his or her discretion regarding the importance of the breach of lease terms, nevertheless regarding the nature of the infringement of the contract (eg, works carried out by the tenant without the landlord's prior approval) the judge may allow himself or herself to consider the gravity of such infringement and refuse to terminate the contract.

Please note that French law is considered rather tenant-friendly with regard to residential leases, which is best demonstrated by article L412-6 of the Code of Civil Enforcement Procedures providing for a prohibition on evicting a tenant from 1 November of the current year until 31 March of the following year.

Financing

33 Secured lending

Discuss the types of real estate security instruments available to lenders in your jurisdiction.

The common security package in real estate financing in France consists of a contractual mortgage or lenders' lien (in certain situations, a mixture of both), an assignment of rents, insurance indemnities and hedge payments, bank account pledges and a pledge of the borrower's shares and, as the case may be, an inter-creditor agreement with the assignment of receivables deriving from a shareholder loan (if any) and a duty of care letter.

Real estate investors can also finance their real estate acquisitions through a finance lease, which allows the tenant to exercise a purchase option after a minimum tenancy period at a purchase price lower than the residual value of the asset.

34 Leasehold financing

Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

Financing is available for long-term leases (such as construction or emphyteutic leases) that provide the tenant with a (temporary) ownership right to the construction on a plot of land. These leases have a minimum term of 18 years (not exceeding 99 years). These concepts are mainly used for commercial purposes, while there was until recently no comparable concept for residential use. With Order No. 2014-159 dated 20 February 2014, the legislature introduced a leasehold concept for the residential sector. Since all these leases are granting a real property right to the tenant (see question 18), the tenant is able to grant the same security package as in a conventional real estate financing operation, with the only difference that the ownership right is temporary and the financing must correspond to the lease term.

35 Form of security

What is the method of creating and perfecting a security interest in real estate?

There are several forms of security over real estate, all requiring a notarial deed. The most commonly used are the mortgage and the lender's lien. Borrowers preferred the latter because of its lower cost; however, the lender's lien can only secure the portion of a loan serving to pay the asset's purchase price. Therefore, most real estate

acquisition financings are secured by a lender's lien (covering the portion of the loan financing the purchase price) and a mortgage (securing the remainder of the loan amount). The loan agreement and related mortgage may include a direct enforcement clause enabling the creditor to appropriate the secured property in the event of a borrower's default (see question 39). This clause must be carefully drafted in coordination with French notaries public. Besides, its intrinsic interest for the lenders should not be overestimated, since its enforcement is restricted and complex.

As far as tangible moveable assets are concerned, the security can be taken by way of a pledge, either with or without dispossession (in the latter case, subject to a filing). Shares, receivables and other intangible assets are pledged (in most cases subject to a notice or filing, depending on the asset type). Receivables can also be assigned by way of security in a standardised statutory manner to the benefit of the lender (by a Loi Dailly transfer). Bank accounts are pledged and cash may be charged in the books of the account-holding bank or deposited with the creditor by way of separate security.

36 Valuation

Are third-party real estate appraisals required by lenders for their underwriting of loans? Must appraisers have specific qualifications?

The appointment of a third-party real estate appraiser is market practice since the lenders need the market value of the property for the calculation and for the definition of financial covenants (LTV, DSCR and ICR). The contractual parties often discuss the nomination of the appraiser, the number of evaluations per calendar year and the cost allocation for such evaluations. The lender has an interest to instruct a reputed appraiser since it will facilitate the syndication or sub-participation process with co-lenders.

Appraisers have specific qualifications and skills in the real estate sector (eg, in relation to land development, public law, insurance, building techniques, etc) and engage their liability when issuing valuation reports.

Guidelines for appraisals are available and promoted by the real estate profession. The French Federation of Real Property Agents and the Chamber of Real Estate Experts have the responsibility to award the real estate valuer certification to appraisers under the control of the European Group of Valuers' Association.

37 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

If not licensed as a credit institution in France, a lender engaging in credit transactions in France on a recurring basis (with or without collateral) must hold an EU financial passport. The lender must be a financial institution located in another EU member state holding a local banking licence. The interpretation of this statute is rather strict: undertaking two lending transactions without a licence will be understood as a violation of the French bank monopoly.

A foreign lender is not liable to French corporate tax solely by granting loans cross-border to French borrowers, unless the lender provides the loan through its French permanent establishment (but withholding tax on interest may apply in certain situations).

The taking of a mortgage or lender's lien requires a notarial deed (see question 35) and triggers the payment of notaries' fees (0.45 per cent on the principal secured). Security registration entails the payment of the registrar's fee and a Land Registry tax (0.05 per cent and 0.715 per cent respectively on about 110 per cent of the principal secured, save that the Land Registry tax does not apply to a lender's lien). These costs are borne by the borrower, further noting that the payment of the Land Registry tax is not required on the transfer of a mortgage or lender's lien.

38 Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

Interest is usually charged at a spread over EuriBOR (plus mandatory costs, if any, imposed by the banking authorities). EuriBOR is an interbank market rate quoted on each TARGET day (Trans-European Automated Real-Time Gross Settlement Express Transfer system) for deposit durations of one, two and three weeks and one to 12 months. Where a fixed interest rate is used, it is determined by reference to the swap rate for three-month EuriBOR applicable to the same period of the loan. In certain cases (such as short broken interest periods or loan tranches financing VAT), the euro overnight rate EONIA may be used instead of EuriBOR. Interest periods are typically three months to match the quarterly rent periods, so the most common rate used as reference is the three-month EuriBOR. In the case of a floating-rate loan (in practice, the most common situation), an interest-hedging arrangement covering 100 per cent of the loan until maturity is generally required.

Usury limitations no longer apply to commercial transactions, but any loan agreement must specify the global interest rate (TEG). The TEG is calculated to reflect all fees and other costs charged to the borrower on top of interest. If the TEG has not been calculated or not disclosed in the loan agreement, the contractual interest rate will be replaced by the statutory (lower) interest rate. Excessive rates may also raise tax and corporate benefit issues.

Please note that lenders' fees and other expenses are not taken into account in the calculation of the high rates.

Thin capitalisation rules and, in certain circumstances, interest rate limits apply to loans from affiliated companies, thus reducing the tax deductibility of interest. Subject to limited exceptions, a bank loan, to the extent that it is secured by security provided by a borrower affiliate, is treated as an intra-group loan for calculating interest deductibility limitations.

39 Loan default and enforcement

How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

In order to be brought against a defaulting obligor, a judicial action is in most cases conditional on the expiry of a formal notice period during which the borrower shall remedy ongoing defaults and shall perform in accordance with the terms of the finance documents. In the case of a payment default, the acceleration of a loan and the subsequent enforcement of a security are possible, but the non-performance of a contractual obligation (except with some limited exceptions, such as the non-compliance of a covenant to sell) will only give rise to a claim for damages and not to specific performance.

A creditor may foreclose on its collateral if the secured debt is due and payable (unless enforcement is stayed as a result of insolvency proceedings). However, courts have a certain degree of discretion to disallow the acceleration of a debt, for example if it is not reasonably justified or its amount is excessive compared to the assets of the debtor. Even in the case of a payment default, the court can give more time (up to two years) to the debtor to avoid its insolvency (article 1244-1 of the Civil Code).

In the case of enforcement of a security, the lender can retain the underlying assets, or require the court to sell it in an auction or require the court to allocate the ownership of the asset to a creditor (subject to the reimbursement to the debtor of any sums in excess of the value of the secured debt). Most collateral types (including mortgages) also allow appropriation by the creditor without court proceedings (except on the debtor's residence), if so agreed in the finance documents (see question 35) and subject to an independent valuation of the asset. It must be noted that all appropriation and enforcement measures immediately become ineffective upon the opening of a safeguard or

insolvency proceedings over the debtors assets (stand-still). If the lender forecloses concurrently against several real estate assets, the relevant court may block the corresponding actions on the debtor's request (pursuant to article 2196 of the Civil Code).

40 Loan deficiency claims

Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

In principle, lenders are entitled to a money judgment for recovery against the borrower or guarantor for any deficiency. As of the date on which the lender knew or should have known the facts enabling it to exercise its right, it will have five years to sue the borrower.

It must, however, be taken into consideration that the borrower generally is a legal entity that borrowed the money on a non-recourse basis with the effect that if the borrower is insolvent its shareholders will not be liable for the company's debt. Assuming that there is personal collateral or a standby letter of credit, the lender could execute its money judgment. It must be noted that the borrower quite frequently files for safeguard or insolvency and thereby obtains a stay so that the execution in the asset will be postponed to the detriment of the asset's value.

In the latter case, the lender must actively participate in the (pre-) insolvency proceedings in order to safeguard its position as a creditor and apply an escalation strategy with regard to the execution of the different security interests and the importance of default of the borrower.

41 Protection of collateral

What actions can a lender take to protect its collateral until it has possession of the property?

There is no concept similar to receivership in France nor is there a concept of mortgagee in possession. Prior to the enforcement of a security interest or the opening of bankruptcy proceedings, the borrower is committed to apply its best endeavours to protect and to preserve its assets, which serve as collateral, in the interest of the lender. The loan and security documentation generally contain covenants, information and reporting obligations of the borrower as well as an inspection right of the lender.

Once the enforcement actions have started or insolvency proceedings are opened, the creditor himself or the court will assume the responsibility for the protection of the collateral until its subsequent sale, disposal or allocation to the creditor.

42 Recourse

May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

In most cases, since an SPV is to be found acting as borrower, the lender has full recourse to all of its assets. This is usually true where the borrower is not an SPV but a commercial company with operating assets, a brand name, employees, etc (eg, a REIT). If the collateral given by the borrower does not suffice to cover the amount of the unpaid debt and related amounts, the lender will have an unsecured claim against all of its other assets, if any, ranking pari passu with all other creditors and thus possibly having little (if any) value. In general, the lender obtains a comprehensive security package with regard to all assets of the SPV, as well as a pledge of shares held by its shareholder (see questions 33, 35 and 40).

The legislature has introduced a provision to invalidate 'excessive security packages'. Case law indicates that a precondition of the application of the provisions is that the lender knew as of the inception of the loan that the borrower was financially unable to honour the loan agreement, while the meaning of 'excessive security package' needs some further clarification.

43 Cash management and reserves

Is it typical to require a cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

A commercial real estate loan agreement typically provides for a cash management system ensuring that all revenues are first allocated to a controlled account serving the purposes of a priority of payments waterfall. In multi-borrower transactions, there is often a cash-pooling mechanism established in addition. The degree of sophistication of these systems varies considerably depending on a number of factors (eg, the financial size of the transaction, type of financing, subsequent securitisation or not of the loan, etc).

Where a loan finances a portfolio of properties held by a number of distinct special purpose entities, cash-pooling mechanisms should be prudently established to avoid corporate-benefit issues for the entities concerned.

In addition, reserve accounts can be set up depending on the objectives of the parties, such as cash trap or cash sweep mechanisms linked to specific triggers or financial covenants, or both.

44 Credit enhancements

What other types of credit enhancements are common? What about forms of guarantee?

A developer must usually provide a bank guarantee for the funding of all works required to achieve completion. The benefit of this third-party guarantee is generally assigned to the owner's lender.

Other than in that context, guarantees are not a common feature of real estate financings, which are generally non-recourse to investors and in most cases without a recourse carve-back. Holdbacks and other enhancements can sometimes be found, depending on the characteristics of the transaction and the commercial negotiation.

There is nothing comparable in France to a limited recourse guarantee for losses or the entire debt in the event of certain 'bad boy' acts of the borrower.

45 Loan covenants

What covenants are commonly required by the lender in loan documents?

In addition to specific financial covenants (see question 46), a commercial mortgage loan agreement would typically include:

- information covenants: financial statements, corporate changes, know-your-client, periodical business plan update, quarterly reports (with rent roll, vacancies, works and insurance events), new leases and surrenders, disposals, material adverse changes, defaults) and periodical financial covenants compliance certificates;
- general covenants: access to records and properties, sound management, compliance with authorisations and taxation, zoning, environmental and other laws, compliance with and enforcement of acquisition, property management and other agreements related to financing, maintaining accounts and hedging with designated banks and cash management;
- negative covenants: restricted activity, no participation in other entities, no investment, works, indebtedness, bank accounts, security, distributions or disposals other than as permitted; and
- property covenants: maintenance and upkeep, carrying out of required works, maintenance of required insurance including loss of rent (with insurers having the requisite rating if a securitisation is contemplated), maintenance of property management agreements in place, compliance with specified restrictions on new leases and periodical valuations.

The level of detail and sophistication of covenants depends on the particulars of each transaction as well as the asset class involved (residential, office, retail, hotel, logistics or industrial). There is no major difference between loans depending on the type of assets. The only

Update and trends

The Reform of the Law of Contract, the General Regime of Obligations, and Proof of Obligations (Ordonnance No. 2016-131 dated 10 February 2016) entered into force on 1 October 2016 (for most of its provisions) and is applicable to all contracts concluded or renewed after 1 October 2016.

Although most of the changes merely codify existing case law, some of them deserve a closer look. They may have an impact on negotiations of lease agreements and real estate transactions and, notably, on the content of the respective documentation. Among others, the following provisions are particularly important.

Public policy provisions

- The principle of good faith is reinforced. It is now a principle of public policy that applies to the pre-contractual stage, the conclusion and the performance of a contract.
- Definition: 'a bespoke contract is one whose stipulations are freely negotiated by the parties. A standard form contract is one whose general conditions are determined in advance by one of the parties without negotiation'.
- Contracting parties have a (reciprocal) pre-contractual duty of disclosure. A party must disclose such information to the respective other party that may be decisive for the other party's willingness to enter into the contract. The drafting of letters of intent, heads of terms and confidentiality agreements as well as the due diligence process must be adapted to this new legal situation.
- In contracts whose general conditions were not negotiated (*contrat d'adhésion*), any clause that creates a significant imbalance is deemed unwritten; the documentation of a contract may now contain a declaration that the parties have discussed all stipulations with each other to avoid any pitfalls.
- Any clause (such as limitation of liability clause) that contradicts the essential obligation of the contract is deemed unwritten.

Auxiliary provisions of interest

- Unforeseeable changes of circumstances: if a 'change of circumstances' that was not predictable at the time of the conclusion of the contract occurs and renders its performance 'excessively onerous for one party', this party may (first) negotiate with the contractual counterparty, but failing such negotiations it may ask the judge to amend the contract or terminate it;
- general provisions relating to the assignment of contracts; and
- creation of the concept of debt assignment.

The reform is of interest to real estate brokers, developers, construction companies and investors of all kinds. It will have consequences for the French real estate market, and the way the new provisions will be applied by French courts in the coming months must be monitored.

difference will relate to the particular representations and warranties provided by the borrower depending on the specific characteristics of the asset and the asset class.

46 Financial covenants

What are typical financial covenants required by lenders?

In most cases, financial covenants clauses are twofold and comprise a loan-to-value ratio (LTV) (with periodical appraisals based on the RICS methodology – usually once a year and at any time if a default is continuing) and an interest cover ratio (ICR), which is usually tested quarterly on a 12-month forward-looking basis and may be used to trigger cash-trap and cash-sweep requirements (or acceleration). A debt service cover ratio covenant (DSCR) is provided for when the loan is amortising. In other cases, where the borrower's revenue is not derived from rent, an EBITDA-based ratio is used to replace the ICR. Finally, in the case of a portfolio credit line destined to finance acquisitions over time, lenders will also require compliance with tailor-made ratios, such as concentration ratios (by location, asset type, etc).

47 Secured moveable (personal) property

What are the requirements for creation and perfection of a security interest in moveable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

Requirements for creating and perfecting security interests depend on the kind of asset secured and the type of security.

Shares

Pledge

Shares in SARLs (limited liability companies under French law) and certain other companies are not classified as financial securities and security is taken through a pledge over the shares themselves. New pledges must be entered into to cover any new shares transferred to or subscribed by the pledgor. As regards perfection requirements, registration of the pledge with the competent public registry is necessary to make the pledge enforceable against third parties.

Securities account pledge

This security interest is available only with respect to securities issued by an SA (public limited company under French law) or SAS (joint-stock company under French law), which have taken the form of entries into paper or electronic accounts. The pledge is created through the execution and delivery by the pledgor of a statement of pledge that must follow a prescribed format. The pledge is recorded in the register of securities transfers and in the register of individual accounts of the issuing company. There are no particular perfection requirements.

Receivables

Pledge

Security may be granted over any (existing or future) receivable through the execution of a pledge agreement in writing between the pledgor and the secured creditor, indicating the secured obligations and properly identifying the relevant receivables and corresponding third-party debtor. While the pledge is enforceable against third parties generally from the date of the pledge agreement, it is not enforceable against the third-party debtor unless and until it receives notice of the pledge. Once the notice is served, it must discharge any payment obligations under the pledged receivable to the secured creditor, regardless of whether acceleration of the secured debt has occurred.

'Dailly' assignment

A company can assign outright (and thereby fully transfer full title to) its present and future receivables arising out of the carrying of a contract or a number of contracts to a credit institution. Assignment is made effective by delivery by the assignor of a delivery form in a prescribed format, which lists the relevant receivables. Notice to the debtor is not required to perfect the assignment, but if payments are to be made directly to the creditor, notice must be given.

Bank accounts: pledge

This security interest is a variant of a pledge over receivables. The debtor notifies the pledge to the credit institution with whom the pledged account is open. The beneficiary generally informs the credit institution that the debtor may operate the pledged account until or unless it receives a blocking notice. However, the pledge will only cover monies standing on the credit of the pledged account as at the date of enforcement of the pledge, and subject to completion of the current transactions affecting the pledged account.

Plant and machinery: pledge

A number of strict and rather onerous requirements apply in order to create this type of security. In particular, it may be granted by the borrower, in favour of a licensed credit institution only, and as security for its payment obligations under loans made available to it for the purpose of acquiring (and not refinancing) identified plant or equipment and must be granted directly in the relevant loan facility agreement. The pledge must be registered with the commercial court having jurisdiction over the place where the inventory is located within 15 days of execution of the loan agreement.

Intellectual property: pledge
Intellectual property rights can be pledged independently from a pledge over ongoing business (see below). Specific registration requirements with the French trademark and patent office (National Institute of Industrial Property (INPI)) apply.

Business activity/goodwill: pledge over ongoing business
This security interest covers:

- leasehold rights with respect to the premises at which the business is being operated;
- some fixed assets (such as machinery, equipment and tools, subject to their not being pledged under a pledge over plant and equipment);
- trade name and goodwill; and
- future assets of the nature of those mentioned above, either not yet in existence or not yet the property of the pledgor at the time the pledge is granted.

Its scope may be extended to include intellectual property rights, which can alternatively be pledged per se (see above). Such a pledge must be registered with the tax authorities within 10 days and with the competent commercial court within 15 days of execution of the pledge agreement.

The beneficiary of any collateral is not required to control or survey it in order to keep the security in full force and effect. The financing and security documentation will transfer such responsibility to the borrower and any violation not remedied during the cure period will trigger a default of the borrower. When the security chosen involves dispossession, the creditor will have to preserve the asset. It can, however, instruct a third party (such as a custodian or a professional depositary) or even the debtor itself.

48 Single purpose entity (SPE)

Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

While not entirely removing the risk of bankruptcy arising from obligations to third parties, SPE status is typically required from an investor seeking a bank financing (with exceptions, such as transactions with REITs).

Such SPE status is achieved through the incorporation of a dedicated commercial company and the drafting of detailed corporate object limitations, negative covenants (including no employees and tight restrictions as to activity and indebtedness) and the subordination of equity and intra-group funding to the bank's lending seniority.

The concept of an independent director is not used. If it were, it would not prevent an insolvency filing, because the management of a company has a legal obligation to proceed with such a filing within 45 days from the occurrence of insolvency. Concerning a filing for an out-of-court reorganisation, the validity of a restrictive covenant in this respect is doubtful.

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General

1 Legal system

How would you explain your jurisdiction's legal system to an investor?

German law follows a civil law system. Real estate law is mainly regulated by the German Civil Code, which deals with the requirements for the acquisition of land and property. A fundamental principle of German law is the principle of the abstract nature of rights in rem. According to this principle, contractual issues are separated from property issues. For example, the violation of a real estate contract does not automatically affect the transfer of property rights. As a consequence of the principle, real estate transactions contain both the contract and the declaration of conveyance.

Real estate disputes are resolved by the civil courts or arbitration. German civil procedure law provides for interim measures, such as interim injunctions, which are orders by the civil courts with provisional effect. The grounds and the entitlement to interim injunctions do not need to be proved but sufficient evidence does need to be provided. Generally, German courts do not rule in equity. However, in several cases where the strict application of the law would not be fair and just, courts rely on general principles of law and analogy of law.

Real estate contracts need to be notarised. Oral contracts are provisionally ineffective. The effectiveness is pending unless the transfer of ownership is not written down in the Land Register. These formal (statutory) requirements are strictly enforced in Germany. However, real estate contracts usually contain a parol evidence rule.

2 Land records

Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

In Germany, there is a system for registration. The Land Register is a public register of real estate property. In the register, ownership and encumbrances (eg, easements, mortgages, land charges or heritable building rights) are covered. The register is, in general, administered by the first instance civil courts. In parts of Germany (eg, in Baden-Württemberg), the Land Register is administered by notaries or by state Land Register offices. In some federal states the Land Register is already available in electronic form.

The transfer of the ownership of a plot of land, the encumbrance of a plot of land with a right and the transfer or encumbrance of such a right require, inter alia, registration of the change of rights in the Land Register. However, due to the principle of the abstract nature of rights in rem, failure to register does not make real estate contracts void or voidable.

Registrations of ownership and encumbrances guarantee title and priority in favour of the person who acquires a right in a plot of land by legal transaction. The contents of the Land Register are presumed to be correct, unless an objection to the accuracy is registered or the inaccuracy is known to the acquirer. This means for real estate transactions that legal ownership is usually evidenced by a mere certified copy of the respective Land Register.

3 Registration and recording

What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

The legal requirement for registration of ownership and encumbrances is the application to the Land Registry. The application can be filed by the person who is affected by the registration or the person who benefits from the registration. In either case, the consent to registration by the person who is affected by the registration is mandatory. The consent to registration must be in the form of a publicly certified document. This means that the consent must be put in writing and the signature of the person declaring must be certified by a notary.

In general, about 10 per cent of the purchase price must be calculated for extra costs. Ownership is taxed separately. Tax rates are set by municipalities and are on average about 1 per cent per year of the property value assessed for tax purposes, which is significantly lower than the market value. The Land Register fees for entering the title change depends upon the purchase price (about 0.2 to 0.5 per cent). Further fees include notary fees (about 1.5 to 2 per cent) and land transfer tax. The land transfer tax rate is set by the federal states. In the past decade, almost all federal states have increased their tax rates or plan to increase their rates. In general, there is a tax rate of 3.5 to 6.5 per cent of the purchase price. The land transfer tax must be paid as a requirement for entry into the Land Register.

Fees and taxes are paid customarily by the real estate purchaser with the exception of fees for the deletion of Land Register records in connection with the purchase (eg, the deletion of land charges). These fees are paid customarily by the real estate seller. However, there are several ways to minimise the amount of fees and taxes. For example, instead of buying the real estate property (asset deal), the purchaser can buy the company that owns the property (share deal); under certain circumstances, land transfer tax can be avoided in particular cases.

4 Foreign owners and tenants

What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

There are no special requirements and no government restrictions for non-resident entities and individuals to own or lease real estate in Germany. However, there are sometimes practical problems for the purchaser of real estate. Land registers demand publicly certified documents from the purchaser of real estate. This also applies to the proof of existence of a foreign company and the admission of its representatives. Therefore, in general, an apostille is required.

5 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

There are no exchange control issues applicable to real estate deals of non-resident investors. There are no restrictions on the repatriation of profits.

6 Legal liability

What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

Owners of real estate face different types of liability. For example, under the German Civil Code, if a customer or a contractor has an accident on the property, the landowner is liable to provide compensation to the insured person for damage resulting from this. Furthermore, the landowner is liable for statutory dues relating to the land, such as charges for local public infrastructure or rubbish-disposal taxes. The key environmental liability issue is the Federal Soil Protection Act. Under this Act, the landowner and even the previous owner can be held liable for contamination of soil and groundwater, even if they did not cause the contamination. Therefore, the buyer should insist on comprehensive soil expertise to determine the soil condition. To avoid later disputes, the parties should clearly define the environmental issues in the contract.

In case of leases, the landlord must surrender the leased property to the tenant in a condition suitable for use in conformity with the contract and maintain it in this condition for the lease period. However, in lease agreements of non-residential premises, it is common that the landlord delegates his or her liability to the tenant to a large extent. Regarding liability for contaminations, tenants are liable as well as the owner, even if they did not cause the contamination.

7 Protection against liability

How can owners protect themselves from liability and what types of insurance can they obtain?

The common way to protect against liability is an insurance, for instance, tort liability insurance and building insurance against weather-related perils, such as fire, lightning, hail and windstorms. In cases of property sales, buildings insurance will be automatically transferred to the buyer who, however, has an extraordinary termination right. Further types of insurance are available for environmental risks, such as water pollution (eg, recommendable in cases of oil tanks on the property).

Buyers can also protect themselves by choosing the appropriate legal vehicle for real estate investments, for example, the limited liability company that shields shareholders from third-party claims.

Furthermore, to protect buyers, appropriate warranties and indemnities should be provided by the seller to cover the situations in which liability may arise from hidden pre-existing defects on the property.

8 Choice of law

How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

Real estate situated in Germany is subject to German law (principle of lex rei sitae). Contractual choices of law provisions are possible. However, they are only applicable in situations involving a conflict of laws.

9 Jurisdiction

Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

In Germany, there are no specific real estate courts or other tribunals. The civil courts have jurisdiction over real estate disputes. Regarding property sales, there are three levels: the regional courts (trial courts), the higher regional courts (intermediate courts of appeal) and the Federal Court of Justice (Supreme Court). In general, claims involving property must be filed in the regional court district where the property is located.

The necessary parties of real estate litigation are the plaintiff and the defendant. However, the plaintiff may seek judgment in default of appearance. Third parties having a legitimate interest in the success of one party can join the litigation. A party must only have legal capacity to enforce remedies in Germany. Further requirements, such as special qualifications to do business in Germany, are not necessary. There are no general requirements for out-of-jurisdiction service. The appropriate method of out-of-jurisdiction service depends on the treaties between Germany and the particular foreign country.

10 Commercial versus residential property

How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

In Germany, laws regarding real estate leasehold differ between commercial and residential properties. There are several non-waivable legal regulations for lease agreements of residential properties (eg, provisions relating to rent increases, termination of the lease, or period of time of leases). German law is strongly influenced by the social protection of tenants. However, these regulations do not apply to non-residential premises. Regarding non-residential premises, it is common that rental contracts are much more landlord-friendly.

Regarding real estate ownership and financing, there are no important differences between commercial and residential properties.

11 Planning and land use

How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

The control or limit of development, construction, or use of real estate is highly regulated. The most important regulation tools are land-use plans by municipalities. There are preparatory land-use plans that represent, in basic form, the type of land uses arising from the entire municipal territory in accordance with the intended urban development that is proposed to correspond to the anticipated needs of the municipality. Furthermore, there are legally binding land-use plans that are to be developed out of the preparatory land-use plan and contain the legally binding designations for urban development. The legally binding land-use plans make special designations regarding the type and degree of building and land use. They are binding for the construction and the use of real estate. However, existing structures with a building permit are protected against new regulation by land-use plans.

12 Government appropriation of real estate

Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

There is a legal regime for expropriation of real estate. However, expropriation is only admissible in individual cases where this is required for the general good and the purpose to be served by expropriation cannot reasonably be achieved by any other means. Therefore, expropriation procedures are quite rare in Germany. Furthermore, where expropriation takes place, compensation is due. Compensation is provided for real estate owners and tenants for rights forfeited as a result of expropriation. Compensation is assessed on the basis of the current market value of the plot to be expropriated or of any other subject of expropriation. In general, there are no exceptions to the payment of compensation for expropriation.

13 Forfeiture

Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

Real estate can be forfeited. If an unlawful act has been committed and the principal or a secondary participant has acquired proceeds from it or obtained anything in order to commit it, the court shall order the

confiscation of what was obtained. This general rule also applies to real estate property.

Real estate property can also be seized if it may be of importance as evidence for the investigation and if it is in the custody of a person and not surrendered voluntarily.

14 Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency system in your jurisdiction.

Under German statutory insolvency law a company is deemed to be insolvent or bankrupt if the company is:

- illiquid;
- over-indebted; or
- if there is a real danger that the company will be illiquid (paragraph 17 et seq of the German Insolvency Code).

In cases of illiquidity and over-indebtedness, as well as the company, any of the company's creditors can apply for an insolvency proceeding. The bankruptcy court will then decide whether to permit an insolvency proceeding. From the date of the court's decision to open the proceedings, the bankruptcy court will appoint an insolvency administrator to act for the company. At the same time, the company's management loses its authority for the management of the company and for the disposal of assets. The insolvency administrator then either liquidates the debtor's assets or tries to prepare an insolvency plan together with the creditors and to continue the business. Recently, insolvency administrators have tried more and more to set up an insolvency plan to ensure the economic survival and reorganisation of the company. A reorganisation might include a sale of the assets of the insolvent entity to a new entity leaving behind the debt in the old insolvent entity. The proceeds from the sale of the assets will be used to satisfy the creditors of the insolvent company.

Upon the beginning of an insolvency proceeding no creditor is entitled to collect rent directly from tenants. If the respective rental claims are assigned to a creditor by way of security, such creditor has a right of segregation, which means that the creditor will be satisfied out of such rental claims with priority. The same applies to creditors secured by liens, land charges and so forth. However, with regard to rental claims, paragraph 110 of the German Insolvency Code sets forth that assignments of rent receivables to third parties, such as lenders, are legally void as they concern time periods after the opening of the insolvency proceeding. This is a legal consequence of paragraph 108 after which rent agreements remain unaffected by an insolvency proceeding and shall be continued with full effect (which requires that rents will be paid to the benefit of the insolvent company and not to third parties as assignees).

Investment vehicles

15 Investment entities

What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

Under German law, real estate investment entities can take several legal forms. The common forms are limited liability company (GmbH), civil law partnership (GbR), limited partnership (KG), stock corporation (AG) and co-ownership. German real estate investment trusts (G-REITs) are another investment vehicle in Germany. However, due to the situation on the capital markets, there are only three G-REITs listed on the stock exchange so far.

Furthermore, open-ended property funds were quite popular before the financial crisis. These funds are managed by capital investment companies. Their characteristic feature is that investors may resell their shares at any time to the investment company. Therefore, they allow investors to quickly withdraw their money. Due to these withdrawal rights, these funds suffer serious problems nowadays. Some funds are still frozen to prevent a mass escape of investors. Some funds were already closed. Other funds will probably follow this route. This opens a huge and attractive market for real estate investments in Germany in the coming years because open-ended property funds have to sell assets in their property portfolio. In 2011, the German parliament enacted the Investor Protection and the Functionality Improvement Act, which, inter alia, provides a two-year period during which new investors are not allowed to resell their shares (with a volume of €30,000 or more per half-year).

Due to tax-efficient returns, closed property funds are another common vehicle to invest in property in Germany. In these funds, only a limited number of investors tie up their money for a specific period of time. In general, the funds hold only a small number of real estate sites. They are usually organised as limited partnerships or civil law partnerships.

Regarding pass-through entities, profits or losses of civil law and limited partnerships pass through to the shareholders personal tax obligations.

Concerning liability issues, limited liability companies are preferred. The limited partner of the limited partnership is also shielded from liability (eg, the limited partner in closed property funds).

16 Foreign investors

What forms of entity do foreign investors customarily use in your jurisdiction?

The choice of legal form depends on the individual circumstances of the case. Inter alia, foreign investors used to buy shares of open-ended property funds. However, due to the turbulence on the market, they are reserved. Launching closed property funds is still common. In general, foreign investors use limited liability companies to acquire high-value properties. Limited liability companies are legal entities established by one or more persons, including legal entities, operating a business or administering assets under a firm name. They have the most flexible structure and generally shield owners from liability for corporate debts and actions of the company. The shareholders of a limited liability company do not bear responsibility for debts or liabilities that have been caused by acts of other shareholders, officers or agents. Furthermore, the minimum share capital of €25,000 is attractive. However, several business transactions have to be notarised, such as amendments to the articles of association or, in contrast with limited partnerships, transfer of shares, which can be disruptive and time-consuming.

17 Organisational formalities

What are the organisational formalities for creating the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

Organisational formalities for creating limited liability companies are contained in the German Law Pertaining to Companies with Limited Liability. The law provides minimum requirements for the establishment of limited liability companies: one or more shareholders may establish a limited liability company by contract (articles of association) that must be notarised. The shareholders can be foreign nationals or foreign companies. However, limited liability companies must have a registered office in Germany. In addition to this, they can have an administrative office abroad where the business activity is predominantly performed. The minimum share capital is usually €25,000. The company must have a managing director who represents the company in its external relations. Foreign nationals may be managing directors but must have the required residence and work permits. The company comes into legal existence upon publication in the commercial register.

The profit of the limited liability companies is subject to corporation tax of 15 per cent plus 'solidarity surcharge' of 5.5 per cent of the corporation tax plus trade tax (about 12 to 13 per cent, differs from municipality to municipality).

Acquisitions and leases

18 Ownership and occupancy

Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

Regarding various categories of legal ownership, the common way is that one person or company owns a plot of land. However, co-ownership

is possible and common. Furthermore, there are some special regulations for individual ownership of condominiums. Moreover, there are heritable building rights that entitle the rights holder to build and own a building on a piece of land for a specific period of time (in general, 99 years). They are often used by municipalities or by the church for residential premises.

Regarding benefits to and burdens on real estate, such as walking and driving rights, easements are common. Via easements, a plot of land may be encumbered in favour of the owner of another plot of land in such a way that the latter may use the encumbered site in specific respects. There are also restricted personal easements. In that case, a plot of land may be encumbered in such a way that the person for whose benefit the encumbrance is made is entitled to use the encumbered site in specific respects.

The encumbrance of a plot of land with a right (eg, easements, restricted personal easements, etc) requires agreement between the person entitled and the other person on the occurrence of the change of rights and the registration of the change of rights in the Land Register. It is also possible that burdens on real estate are only agreed by contractual agreements between the parties. However, these contractual agreements are more uncertain because they only apply to the acting parties. In case of change of ownership of real estate premises, it is not ensured that the new owner is bound by contractual agreements.

Regarding leaseholds, German law differs between normal lease and some special kind of leases, such as usufructuary lease and farm lease. A usufructuary lease imposes on the lessor the duty to allow the lessee, for the lease period, the use of the leased object and the enjoyment of its fruits. By means of a farm lease, a plot of land with the residential and utility buildings (business) that serve its cultivation, or a plot of land without such buildings, is leased largely for agriculture. There are some special regulations for usufructuary lease and farm lease. There are also specific regulations for leases for residential space that do not apply to leases for non-residential premises. Subletting contracts are also common. However, without permission of the lessor, the lessee is not entitled to sublet the leased property.

19 Pre-contract

Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

In Germany, it is not customary to execute a form of non-binding agreement before the execution of a binding contract of sale because non-binding agreements are invalid. The courts do not enforce non-binding agreements. However, it is customary to take the property off the market during negotiation of a contract. Nevertheless, sellers may negotiate with more than one party (bidding procedure). The seller is liable for the break-up of contract negotiations only under rare circumstances.

20 Contract of sale

What are typical provisions in a contract of sale?

The key provisions in a contract of sale cover the object of sale including Land Register entries, the parties of the contract, the purchase price or its calculation method and the declaration of conveyance. Typical further provisions deal on a case-by-case basis with the payment date, payment mechanisms, the liability for defects, the change of possession, development costs and other public charges, environmental liability issues and rights of withdrawal.

Common warranties are related to property ownership, third-party rights, quality or state of the property sold, contaminations, compliance with building permits, time frames for the end of construction works, change of possession, encumbrances, liability for defects, validity of existing leases, rental income and payment of taxes. In large real estate portfolio sales, sellers usually give only limited representation and warranties.

The purchase price is often paid into an escrow account maintained by the notary and transferred to the seller only when the Land Register entry is complete. However, to save fees, the parties should choose other options (eg, payment after the priority notice of conveyance has been registered).

In general, a title search is done at the seller's expense.

Unless otherwise agreed, the seller is obliged to bear public service development charges and other municipal development charges for construction measures which began before the contract was entered into, irrespective of the point of time when they became payable.

21 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

In Germany, there is a very strict statutory liability for environmental clean-up. Under the Federal Soil Protection Act, the polluter and its legal successor, the lessee, the current and, under certain conditions, even the previous landowner and the landowners' parent company can be held liable for contamination of soil and groundwater. The landowner can be held liable even if it did not cause the contamination.

Furthermore, the Environmental Damages Act, which is based on European law, contains a statutory liability for environmental clean-up. Therefore, covenants must be cautiously structured on a case-by-case basis to make sure they apply to every possible environmental liability situation. In practice, unclear environmental clean-up issues are often the deal breaker.

22 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

Typical representations made by sellers of property regarding existing leases provide that leases are valid, that the lessees are not in breach of their obligations, and that there are no threatened or pending disputes with lessees.

Typical covenants made by sellers of property concerning leases between contract date and closing date are that the seller will not execute new leases or amend existing leases without the consent of buyer, that the seller will not execute any brokerage agreements for leases, and that the seller will complete all incomplete improvement work.

Estoppel certificates from lessees are not common in Germany.

23 Leases and real estate security instruments

Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

In general, the purchase is subject to existing leases. If leased residential space is disposed of by the lessor to a third party, then the acquirer, in place of the lessor, takes over the rights and duties that arise under the lease agreement. However, in the case of foreclosures, the acquirer has a right of termination. This also applies to ground (or head) leases.

24 Delivery of security deposits

What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

Under a lease, security deposits are common in Germany. They may amount to three times the monthly rent at the most and may be granted by way of a bank guarantee. According to German law, if the lessee of the residential space disposed of has provided security deposits to the lessor, then the acquirer takes over the rights and duties created by this. Generally, the seller gives a warranty that all security deposits will be handed over to the buyer.

Leases for non-residential premises customarily have periodic rent reviews. In general, rent will be adjusted annually based on increases in the consumer price index. Regarding leases for residential premises, there are specific legal regulations for an increase in rent (eg, regulations about rent increase in case of modernisation, increase in rent up to the reference rent customary in the locality, or form and justification of the rent increase).

25 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain a zoning report or legal opinion regarding legal use and occupancy?

As noted in question 2, entries in the Land Register are presumed correct. Therefore, title search is not customary. Usually, legal ownership is proved by a certified and current copy of the respective Land Register.

Regarding the priority among the various interests in the estate, there is a ranking order. The order of priority of more than one right with which a plot of land is encumbered is determined, in general, by the sequence of the entries. An arrangement of the order of priority that deviates from the general rule is possible. However, this arrangement must also be registered in the Land Register.

26 Structural and environmental reviews

Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

It is customary to arrange engineering or environmental reviews, especially in high-value projects. Due to the very strict statutory liability for environmental clean-up (see question 21), legal opinions are common. Engineering and environmental representations and warranties occur but, in general, sellers are conservative. Usually, sellers only give copies of existing engineering and environmental reports but no warranties. It is often up to the buyer to commission additional reviews.

In certain projects (eg, hotel complexes, commercial centres, theme parks) in areas not yet developed, the investor could be obliged to carry out an environmental impact assessment to examine the possible negative impact on the environment.

Environmental insurance is available (eg, clean-up policies, clean-up cost caps).

27 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

Usually, in real estate transactions and due diligences, leases will be reviewed by both lawyers and on the business side. However, due to the principle that the buyer takes over the rights and duties that arise under lease agreements, the legal review of leases is shortened. It is focused on the value of the contracts, the contract periods (including renewal options), the possibility of rent increases, arrears of rent, pending or threatening lease disputes, the rights of (premature) termination, the legal effectiveness (especially the compliance with written form requirements) and change of control clauses in the contracts.

Regarding property management agreements, the agreements on the payment of management costs and the agreements on renovation, maintenance and restoring the building are also important issues in the review of leases.

28 Other agreements

What other agreements does a lawyer customarily review?

Lawyers customarily review on a case-by-case basis construction contracts, facility management agreements, fire protection issues, area calculations, rights of pre-emption (especially municipal pre-emption rights), public easement registers, former contracts of sale, building permits and their accordance with German building legislation such as the Federal Building Code and the building ordinances of the federal states. Due to rising energy costs, energy-saving issues have become more and more important in real estate transactions. Since 2009, buyers have the right to obtain energy performance certificates for buildings from the seller.

29 Closing preparations

How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

Usually, real estate purchase agreements are drafted by lawyers and are forwarded to the notary. Then the notary will take care of the organisational issues, such as examination of the entries in the Land Register, insertion of the entries into the agreement, and contact with the respective authorities and the financing banks. The closing of real estate transactions is usually the entry of the transfer in the Land Register. The time frame between the signing of the real estate sale contract and the entry of the transfer in the Land Register depends on the workload of the respective Land Registry office. The entry of the transfer can take several weeks or even more.

Regarding financing agreements, lawyers will ensure that the conditions precedent for the disbursement will be fulfilled in time. Usually such conditions precedent include the required examination of the securities and the land purchase in the public (land) registers, the issuance of customary legal opinions and proof that all funds necessary for the completion of the project are granted or are (in the case of equity) available.

30 Closing formalities

Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

A contract by which one party agrees to transfer or acquire ownership of a plot of land must be recorded by a notary. Furthermore, the agreement between the alienor and the acquirer (declaration of conveyance) necessary for the transfer of ownership of a plot of land must be declared in the presence of both parties before a competent agency. Any notary is competent to receive the declaration of conveyance. The parties must not appear in person before the notary. Agents can act for them in front of the notary (for fees and taxes see question 3).

31 Contract breach

What are the remedies for breach of a contract to sell or finance real estate?

There is no specific regulation of remedies for breach of a contract to sell or finance real estate. In general, by a purchase agreement, the seller is obliged to deliver the plot of land to the purchaser and to procure ownership for the buyer. Furthermore, the seller must procure the plot of land for the purchaser free from material and legal defects. If the plot of land is defective, the purchaser may revoke the agreement, reduce the purchase price or demand damages. However, in real estate contracts, the parties usually agree upon an extensive exclusion of liability.

The purchaser is obliged to pay the seller the agreed purchase price and to accept delivery of the thing purchased. If the purchaser breaches this duty, the seller may, inter alia, demand damages for the damage caused thereby. If the purchaser does not pay the agreed purchase price that is due, then the seller may also revoke the contract under certain circumstances.

Under the finance agreement, the borrower is obliged to disburse the granted loans as soon as the conditions precedent for the disbursement are fulfilled. If the borrower breaches the disbursement obligation he or she is liable for all losses incurred as a result of such breach of contract.

32 Breach of lease terms

What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply?

There are specific real estate rules regarding breach of lease terms. For example, if the leased property has a defect that invalidates its suitability for the contractually agreed use, then the tenant is exempted for the period when suitability is removed from paying the rent. For the period of time when suitability is reduced, the tenant need only pay reasonably reduced rent. Furthermore, if a defect of the leased property arises due to a circumstance that the landlord is responsible for, the tenant may also demand damages.

The landlord may terminate the lease for cause without notice for a compelling reason. Inter alia, a compelling reason is deemed to apply in cases where the tenant is in default, on two successive dates, of payment of the rent or of a portion of the rent that is not insignificant.

In contractual lease agreements regarding non-residential premises, these specific real estate rules regarding breach of lease terms are often waived in favour of the landlord.

Financing

33 Secured lending

Discuss the types of real estate security instruments available to lenders in your jurisdiction.

Apart from exceptional cases, real estate funding in Germany is usually secured by a package of different securities. First, the financing banks insist on a lien on the financed property. In Germany, there are two different kinds of such liens on property, the mortgage and the land charge. As the land charge is independent from the specific credit facility and therefore could be used, for example, for follow-up financing, in most cases the land charge is preferred.

Moreover, especially when an SPE (see question 48) is used for the transaction, the financing banks ask for liens on the (SPE) company's shares and other intangible assets, like IP rights and personality, and so on. The method and formalities for granting such liens depend on the kind of security. In some cases, the financing banks furthermore insist on personal guarantees of the parent company of the SPE, and so forth. In addition to this, the financing banks usually insist on a lien on the bank accounts, which is normally stated in the institution's general terms and conditions. Usually, the financing banks insist also on direct access to the rent receivables and therefore demand a blank assignment of all claims against the tenants of the financed property (assignment by way of security). In addition to the aforementioned liens, the loan agreements usually include a package of financial covenants and general undertakings.

34 Leasehold financing

Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

As a ground lease has an historical background in Germany (the ground lease system was founded about 100 years ago and one of the reasons for developing this was a financial one) and as it is still quite common, there are financings available for developers using ground leases. The main advantage is that developers do not need to raise huge capital investments to 'buy' land for real estate development. As the ground lease under German law is quite similar to the purchase of ground, there are generally no material legal differences regarding the financing of such developments (eg, it is possible to secure a loan by a land charge on the ground lease). There are some specific requirements for mortgages (eg, regarding the term, time limits and the volume of the loan).

35 Form of security

What is the method of creating and perfecting a security interest in real estate?

The mortgage and the land charge must be registered in the Land Register and the approval of the property owner of the respective real estate must be in notarised form.

The method and formalities for granting liens on company's shares (eg, the shares of a used SPE) depend on the kind of security. Personal securities such as a guarantee or a comfort letter can usually be granted with an oral agreement. The same applies with regard to assessments of receivables, for example, the assessment of the claims against tenants. However, in practice there are only written agreements.

36 Valuation

Are third-party real estate appraisals required by lenders for their underwriting of loans? Must appraisers have specific qualifications?

Most German banks that are engaged in real estate financing have special departments that handle the valuation of the real estate to be financed, sometimes also acting for other banks or financing institutions as the security agent of the transaction. However, the collateral value under the Mortgage Bond Act must be set forth by an independent evaluator (see paragraph 16 of the Mortgage Bond Act). Under specific requirements the evaluator can be an employee of the lender, but must be independent and must not be engaged in the credit process and credit decisions and must be qualified as set forth in the Pfandbrief Act and an additional executive order law. In particular it must have special expertise in the valuation of real estate.

37 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

There are no specific requirements and no specific taxes if a loan from a lender from another jurisdiction shall be secured by collateral under German law. However, the most important real estate securities like the land charge and the mortgage must be notarised and registered in the Land Register. So, the establishment of liens triggers the obligation to bear fees (ie, the registration fee) that are in practice assumed by the debtor.

The assignment of a land charge or mortgage to a new debtor is possible under German law. However, there are specific requirements that must be considered. The kind of requirements that have to be fulfilled depends on the kind of the security, for example, a land charge can only be assigned to a new debtor together with the loan or underlying claims. In most cases the assignment of a land charge or mortgage has to be registered with the Land Register that triggers registration fees and requires an approval of the transferor in notarised form.

38 Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

The interest rate on property loans in Germany customarily consists of the margin plus the refinancing rate, which is usually EuriBOR and rarely LIBOR. We often see the three-month EuriBOR as the benchmark reference rate or that the debtor is entitled to choose the length

Update and trends

The land transfer tax is still a current hot topic in Germany. In addition to the trend towards higher land transfer tax rates, the ministers of finance of the federal states of Germany want to stop exemptions from land transfer tax regarding specific real estate transactions by regulatory changes. This mainly concerns the transfer of shares of real estate companies. Specific legislative proposals have not been presented yet. Therefore, the advantages of share deals instead of asset deals regarding real estate transactions could be lower in the future.

of interest period and therewith the relevant EuriBOR. In recent transactions, and with regard to actual and past market disruptions, the definition of EuriBOR/LIBOR set forth that the minimum rate to be calculated with is zero per cent, which means that no negative reference rate is accepted and the lender shall at least pay the full margin. The margin usually depends upon several issues, such as the collateralisation of the debt, the rating of the debtor, general market conditions and so forth. At the moment we are seeing moderate (but rising) margins as there is a lot of money in the (refinancing) market. However, this trend could end quickly, so at present it is a good time for investment or refinancing of existing loans. As well as the margin and the benchmark reference rate, the debtor usually assumes several costs, such as mandatory costs, capital resources costs and handling charges. An unreasonably high interest rate can be illegal under German law. The consequences depend upon the individual case and vary from a reasonable reduction of the margin to the nullity of the loan agreement.

39 Loan default and enforcement

How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

In general, the lender has to file a lawsuit against the debtor in the case of a default to get an 'executor title' against the debtor. With this title the debtor can initiate an execution against all assets of the debtor and the lender can realise all types of collateral. To avoid court proceeding to get an executor title, loan agreements (or collateral agreements) usually contain a provision that entitles the lender to immediate execution. Such a clause is (for the lender) advantageous as it reduces the duration for a foreclosure proceeding significantly. The foreclosure proceeding can be initiated as soon as the requirements therefore have been met. The most common requirement is a (material) monetary default.

There are no restrictions on the types of legal actions by lenders.

40 Loan deficiency claims

Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

Under German law lenders are entitled to recover a money judgment against the borrower or any guarantor of the loan if the foreclosure was not sufficient and there are time limits, but no specific limitations on the amount or the calculation methods.

41 Protection of collateral

What actions can a lender take to protect its collateral until it has possession of the property?

Common German loan agreements contain several covenants with regard to the protection of the collateral, that is, the property must be properly maintained and insured, and so on, and key lease agreements may only be cancelled with the prior consent of the lender. In addition to this, German statutory law contains several provisions with regard to protection of collateral. For example, the debtor is not allowed to let the collateral (ie, the financed property) deteriorate.

With regard to rents, the lender usually insists on an assignment of the rents by way of security (blank assignment by way of security). In the case of a delay in payment, the lender can then demand payment from the tenants directly to him. In addition to this, the scope of a land charge includes the rents, insurance claims, and so on. Such receivables can be realised by way of a sequestration until or instead of the foreclosure sale of the property. Under specific circumstances a sequestration can, as mentioned, also replace a foreclosure, in particular if the real estate generates enough cash flow to serve the loan. There are no specific risks of such sequestration for lenders as it is an official enforcement action and the sequestrator is appointed by the execution court and acts under its own responsibility and under supervision of the execution court.

42 Recourse

May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

The recourse to (all) of the assets of the borrower is regardless of the security documentation, as under German law each creditor who has an 'execution title' (see question 39) can initiate an execution into all kinds of assets of the borrower. The importance of security packages arises in the case of the borrower's bankruptcy, as then the claims of the secured party will, generally speaking, be satisfied preferentially by executing the securities.

A personal recourse to guarantors is usually not limited to actions, such as bankruptcy filings or other statutory prior rankings like the previous (execution) sale of the property. Nevertheless, such prior rankings could be set forth in the guarantee agreement. Usually, a guarantor is liable as soon as the debtor is in default of payment.

43 Cash management and reserves

Is it typical to require a cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

With regard to real property transactions it is quite uncommon in Germany for lenders to require cash management systems and ask for reserves. However, loan agreements sometimes contain financial covenants with regard to general solvency. The financing banks will also make sure that the legal entity that collects the rent receivables from the tenants of the financed property is a (direct) borrower of the loan and is liable for all claims of the financing banks. In addition to this, the financing agreements mostly include 'ring-fencing' regulations, such as the prohibition of certain dividend payments, the prohibition of any payments to or agreements with the shareholders that are not at arm's length or the prohibition to grant any loans to third parties, etc.

44 Credit enhancements

What other types of credit enhancements are common? What about forms of guarantee?

Letters of credit and bank guarantees are common in Germany. The same applies to completion guarantees, which are – like payment guarantees – enforced by a unilateral action against the guarantor. In completion guarantees the guarantor undertakes either to pay another constructor for the completion of the project or to pay the amount needed for the completion of the project. It is also possible to agree on a 'guarantee of first demand' that must be fulfilled by the guarantor upon demand of the beneficiary without any other proceeding.

Carve-out guarantees are sometimes used in securitised loans with SPEs as debtors. When there is no recourse in general, the lender wants to secure by using a recourse carve-out guarantee that the debtor properly maintains the collateral and ensures its value and avoids breaches

of important covenants like giving fraudulent statements to the lender or not to pay due taxes, and so forth.

45 Loan covenants

What covenants are commonly required by the lender in loan documents?

German real property loan documentation contains the covenants that are commonly found in Anglo-American loan agreements (LMA-Standard). In particular:

- general covenants or undertakings – compliance with law and tax, hedging with financing banks, and so on;
- property-related covenants – maintenance of the property, required insurance, and so forth, compliance with public law, in particular building law;
- information covenants – financial statements, quarterly reports, change of control, no material adverse change, no insolvency proceedings, no defaults, etc;
- negative covenants – negative pledge clause, no participation or no investments in other property or entities, no additional loans, no loans of the borrower to shareholders or other persons; and
- financial covenants – see below.

46 Financial covenants

What are typical financial covenants required by lenders?

German real property loan documentation contain the financial covenants that are commonly found in Anglo-American loan agreements (LMA-Standard) to ensure a minimum loan-to-value ratio and a minimum debt-service coverage ratio. The usual financial covenants are the debt/equity ratio, the income (EBIT)/debt ratio and the rental income/interest ratio.

The reporting obligations of the borrower are usually on a periodical basis, and contain in particular the disclosure of financial statements and the disclosure of quarterly reports.

47 Secured moveable (personal) property

What are the requirements for creation and perfection of a security interest in moveable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

Under German law, security interests in tangible assets are created by agreement. In addition to this, the statutory law requires that the secured party acquires direct or indirect possession of the assets. In practice, the debtor retains direct possession of the assets but holds the asset for the secured party, which is then an indirect possessor (transfer by way of security). The details vary depending on the kind of asset and the form of security.

A pledge of claims needs to be announced to the debtor. Hence, a pledge of claims is not very common in Germany. Instead of a pledge of claims (such as the claims against the tenants of the financed property), borrowers usually assign all claims to the financing party, and the financing party allows the borrower to collect the claims until a default event occurs.

48 Single purpose entity (SPE)

Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

SPEs are commonly used in Germany but are usually not required from lenders. There is no specific statutory law for SPEs, thus the general German corporate law applies. There is also no concept of an independent director of SPEs.

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General

1 Legal system

How would you explain your jurisdiction's legal system to an investor?

Ghana's legal system is founded on the common law system as developed in the United Kingdom. Article 11(1) of the 1992 Constitution defines the sources of law in Ghana to comprise the Constitution, enactments made by or under the authority of Parliament established by the Constitution, any orders, rules and regulations made by any person or authority under a power conferred by the Constitution, the existing law and the common law. What amounts to common law is defined by the Constitution to include the rules generally known as the doctrines of equity and the rules of customary law including those determined by the superior courts of judicature.

The court system is structured into two arms; namely the superior courts of judicature and the lower courts and tribunals. Superior courts of judicature are the courts of record. The superior courts currently comprise the Supreme Court, Court of Appeal and the High Court and regional tribunals. The lower courts comprise the circuit courts, district courts and judicial committees of traditional councils, regional houses of chiefs and the national house of chiefs. The circuit and district courts have original jurisdiction in land or real estate matters.

Generally in Ghana, a contract for the transfer of an interest in land has to be in writing in order for it to be enforceable, unless that requirement is relieved by a statutory provision. The statutory provisions waiving the requirement for writing include cases where the transfer is by operation of law; by operation of the rules of equity relating to the creation or operation of resulting, implied or constructive trusts; by order of the court; by will or upon intestacy; by prescription; by a lease taking effect in possession for a term not exceeding three years, whether or not the lessee is given power to extend the term; by a licence or profit other than a concession required to be in writing by the relevant statutory provision; and by oral grant under customary law. Thus, unless an oral contract is under customary law, the transfer would have to comply with the requirement for writing.

Real estate is one of the leading subject matters of litigation in Ghana. The common sources of land litigation include the absence of documentary proof of land ownership, the absence of maps and plans of land and ascertainment of boundaries. The court, in its bid to maintain the status quo or preserve the subject matter of the litigation, pending the final determination, would grant interlocutory injunctions to applicants as it deems fit. The courts also admit parol evidence in accordance with the applicable law in their determination of cases.

2 Land records

Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

There are two parallel systems of registration in Ghana, namely the registered and unregistered land systems. Land title registration started in Ghana in 1987 with the coming into force of the Land Title Registration Law 1986 (PNDCL 152). In preceding periods, the operating system was the deeds registration or registration of instruments affecting land, which started as far back as 1883 and continues under the operation of the Land Registry Act 1962 (Act 122).

The object of PNDCL 152 is to cure the deficiencies of the deeds registration system by providing a credible public record of land ownership and interests therein. Accordingly, under PNDCL 152, registration of titles to land or interests therein at the Land Title Registry is mandatory in all areas declared registration districts. PNDCL 152, however, allows the continued registration of instruments under the Land Registry Act in respect of lands or interests therein located in unregistered districts (ie, areas outside the designated registration districts under PNDCL 152). In essence, deeds registration under Act 122 will continue insofar as some lands or areas remain to be declared registration districts.

The Land Register is conclusive evidence of title of a proprietor of any land or interest in land appearing on it and the rights of the proprietor shall be indefeasible and shall be held by the proprietor together with all privileges and appurtenances attaching thereto free from all other interests and claims.

Registration of an instrument affecting land, under Act 122, constitutes actual notice of the instrument and of the fact of registration to all persons and for all purposes, as from the date of registration, unless otherwise provided in any enactment. Accordingly, registration of an instrument affecting land only confers priority on the registered instrument over other instruments affecting the same land. The title of the owner is not registered under Act 122 even though the registration of the instrument in respect of the land in question may facilitate proof of title to the land. Thus, if the title to the land is proved to be defective, mere registration of an instrument cannot be pleaded in any court of law as an answer to an action for the recovery of the land. Consequently, if the vendor named in the instrument has no title to the land that is the subject matter of a sale, the person who has good title to the land will succeed in obtaining possession of the land even without any registered instrument.

3 Registration and recording

What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

Act 122 requires that for an instrument affecting land to be registered it should be proved. The act requires that the proof be on oath and before a registrar of lands, a magistrate or a judge.

Furthermore, the Stamp Act (Amendment) Law 1988 (PNDCL 204) requires that the instruments be stamped at the appropriate authority, the Land Valuation Department of the Ghana Revenue Authority, within two months. Failure to stamp the instrument within the stated time attracts a penalty. In respect of registered lands, section 95 of PNDCL 152 provides that 'no instrument required by any enactment to be stamped shall be accepted for registration unless it is duly stamped'.

Section 60 of PNDCL 152 requires a proprietor to apply for the registration of an instrument relating to any disposition affecting registered land within three months after the execution of such instrument. Failure to comply with this provision will attract an additional fee not exceeding five times the fee prescribed unless waived by the Land Registrar depending on the prevailing circumstances.

4 Foreign owners and tenants

What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

Ghana's 1992 Constitution prohibits the creation of any interest in land or right over land that vests in a person who is not a citizen of Ghana. An agreement, deed or conveyance of whatever nature that seeks to create such freehold interest is void.

Non-citizens are, however, permitted by the Constitution to have a leasehold interest for a term of up to 50 years and the lease may be bought, sold or renewed for consecutive terms. Any leasehold created for a tenure exceeding 50 years at any one time is void.

5 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

The Foreign Exchange Act 2006 regulates exchange control issues in Ghana. Under this act, exchange control issues are handled by authorised dealer banks and not solely by the central bank, the Bank of Ghana, as was the practice before 2006. The dealer banks are simply required to report their foreign exchange dealings to the Bank of Ghana. Repatriation of funds or dividends and payments in foreign currency to or from Ghana between a resident and a non-resident or between non-residents must be made through an authorised dealer bank. There are no exchange control or currency regulations as long as the transaction is effected through these banks.

Investors under the Ghana Investment Promotion Centre (GIPC) Law are guaranteed free transfer of profits, interests, fees, charges, loan repayments and liquidation proceeds, while expatriates are allowed to transfer a certain quota of their annual earnings. Non-resident companies are, in principle, free to transfer their net after-tax profits abroad, provided the transfer is carried out through persons approved by the Bank of Ghana.

6 Legal liability

What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

An owner of real estate faces the liability of loss of property and general tort liability. The owner is also liable to pay statutory rates and charges imposed on the land such as property tax. The tenant is also liable to take out contents insurance and pay bills in respect of amenities supplied such as electricity, water and telephone.

Whether there can be liability for subsequent owners and tenants depends on the type of agreements or covenants reached between the parties. Where there are restrictive covenants, for example, they would duly apply. On the other hand, a lender faces the main liability of a borrower's default in repayment. This liability is mitigated, however, by the operation of the Borrowers and Lenders' Act 2008 (Act 773), the Mortgages Decree 1972 (NRCD 96) and the Home Mortgage Finance Act 2008 (Act 770).

7 Protection against liability

How can owners protect themselves from liability and what types of insurance can they obtain?

Owners can protect themselves from liability through insurance policies. The following are a range of available insurance policy options to owners of real estate:

- homeowners' and renters' policies;
- comprehensive general liability policies;
- landlords' policies; and
- tenants' policies.

8 Choice of law

How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

Real estate transactions involving properties in Ghana are governed by Ghanaian law. Parties are at liberty to choose the applicable law to govern real estate contracts involving properties in two jurisdictions. However, for contractual choice of law provisions to be enforceable in Ghana, the contract should be executed in Ghana.

9 Jurisdiction

Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

The circuit, district and high courts of Ghana have original jurisdiction to be determined by the value of the property. Generally, the parties to be joined in an action in order for it to proceed are the necessary and proper parties for the conclusive determination of the action. Specifically the High Court Civil Procedure Rules, 2004 (CI 47) provide that two or more persons may be joined together in the same action as plaintiffs or defendants without leave of the court where, if separate actions were brought by or against each of them, some common question of law or fact would arise in all the actions and where all rights to relief claimed in the action whether they are joint, several alternatively are in respect of or arise out of the same transaction or series of transactions.

In the main, no writ is to be served out of the jurisdiction. However, notice of a writ may be served out of the jurisdiction with leave of the court provided in specific cases. An application for the grant of leave is to be supported by an affidavit stating the grounds on which the application is made and stating that, in the deponent's belief, the plaintiff has a good cause of action and shows in what place or country the defendant is or may probably be found.

Enforcement of foreign judgments in Ghana is based on the doctrine of reciprocity. On this basis, judgments from Brazil, France, Israel, Italy, Japan, Lebanon, Senegal, the United Arab Emirates and the United Kingdom are enforceable.

10 Commercial versus residential property

How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

The present law governing the transfer of land or interest in land in Ghana is the Conveyancing Decree 1973 (NRCD 175), while that which relates to the control of rents and recovery of possession of premises is the Rent Act 1963 (Act 220). Both laws do not necessarily distinguish between real estate ownership and tenancy in respect of commercial and residential properties. With regards to financing, however, the Home Mortgage Finance Act 2008 (Act 770) is intended to regulate home mortgage financing and related matters. Though there is no clear-cut distinction between the laws relating to ownership and tenancy regarding commercial and residential properties, in practice, however, the form of their respective transactions is different. A lease of commercial premises, for example, is quite different from that of a residential lease. There are many factors or issues that have to be dealt with when executing a commercial lease. For example, although the tenant's solicitor will have to review the documents, there are other people who may provide inputs before the lease is finalised. It is important to note that after completion, the lease will become a reference document and will be consulted on estate management matters as they arise during the term. Prior to the execution of the lease, there are some important matters that the lessee's solicitor must address before recommending the transaction to his or her client. A

commercial lease should factor in considerations such as town and country planning legislation.

11 Planning and land use

How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

The planning and zoning regime of Ghana comprises a number of laws including the Local Government Act 1993, the National Development Planning Commission Act 1994, the National Development Planning (Systems) Act 1994, the National Building Regulation 1996 and the Town and Country Planning Ordinance 1945.

The Local Government Act establishes and regulates the local government system of Ghana in accordance with the Constitution. The basic unit of the local government system is the district assembly (DA), which constitutes the highest political authority in the district, exercising both political and administrative authority.

The DA is the planning authority and therefore responsible for physical and spatial planning of customary land in conjunction with the Stools (see question 18). The DA is responsible for approving all planning schemes before they can take effect. The DA is also responsible for granting permits for development, as the Local Government Act expressly provides that no physical development shall be carried out in a district without prior approval of the DA.

12 Government appropriation of real estate

Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

Article 20 of the Constitution 1992 empowers the state to compulsorily acquire land in the public interest subject to the prompt payment of fair and adequate compensation. The constitutional provision further makes the compulsory acquisition contingent on there being a law that provides any person with an interest in or right over the property with a right to appeal at the high court to determine their interest or right and the amount of compensation to which they are entitled.

Any property compulsorily taken possession of or acquired in the public interest or for a public purpose shall be used only in the public interest of for the public purpose for which it was acquired. Where this is not the case, the owner of the property immediately before the compulsory acquisition is given the first chance to acquire the property and shall, on such reacquisition, refund the whole or part of the compensation paid as provided for by the law or such other amount as is commensurate with the value of the property at the time of the reacquisition.

13 Forfeiture

Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

Real estate can be forfeited or confiscated in circumstances where the acquisition of such property is linked to a crime committed by a person for which he or she has been found guilty and convicted.

Furthermore, failure to secure a land title could result in forfeiture of the property without monetary compensation.

14 Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency system in your jurisdiction.

Bankruptcy and Insolvency proceedings are governed by the Bodies Corporate (Official Liquidations Act) 1963 (Act 180), the Insolvency Act 2006 (Act 708) and the Companies Act 1963 (Act 179).

Under Act 180, the official winding up of a company may be commenced by:

- a special resolution of the company stating that the company shall be wound up by way of an official winding up;
- a petition generally by a creditor of a company or a member or contributory of a company addressed to the Registrar of Companies;
- a petition by a creditor of a company or a member of a company and in some cases (ie, where the business or objects of the company are unlawful or the company is operated for an illegal purpose or the business being carried on by the company is not authorised by its regulations) by the Attorney General to the Court; or
- a conversion from a private liquidation.

Proceedings under Act 708 in respect of a debtor – not being a body corporate – is initiated by the presentation of a petition (either by a creditor or the debtor himself or herself, given the appropriate context) to the official trustee in a prescribed manner and accompanied by a prescribed fee. The purpose of this petition is to have the official trustee grant a protection order, to conserve and protect the debtor's assets for the benefit of his or her creditors pending the court's determination of the debtor's affairs.

Investment vehicles

15 Investment entities

What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

Prospective investment entities in Ghana must register a wholly owned limited liability company, a joint venture with a Ghanaian partner or a branch office in Ghana. The investor, whether Ghanaian or foreign, who wants to establish a resident business entity must register with the Registrar General's Department under one of the governing laws. The laws governing the establishment of a business in Ghana include the Companies Code 1963, the Partnership Act 1962 and the Business Name Act 1962. Where the entity is to operate in the country as a representative of a non-resident business, there is no requirement for incorporation under the Companies Code. The required documentation would only have to be entered in the register of external companies by the Registrar of Companies.

Investment incentives for real estate entities include a five-year tax holiday, under the GIPC Law.

16 Foreign investors

What forms of entity do foreign investors customarily use in your jurisdiction?

A company is usually the preferred form of legal entity that investors establish. The investor may incorporate either a limited liability company or an unlimited company. According to the Registrar General's Department, foreign investors usually incorporate limited liability companies.

17 Organisational formalities

What are the organisational formalities for creating the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

A foreign investor may team up with a Ghanaian entrepreneur or company for a joint venture in the form of a partnership or a limited liability company. Under the Ghana Investment Promotion Centre Act 1994 (the GIPC Law), minimum equity capital of US$10,000 is required from any foreign investor who intends to enter into a joint venture partnership with a Ghanaian. The foreign shareholder is required to satisfy this minimum equity capital either in cash transferred through Ghana's banking system or its equivalent in the form of goods, plants and machinery, vehicles or other tangible assets imported specially and exclusively to establish the enterprise.

Foreign nationals are permitted 100 per cent ownership of an enterprise provided they satisfy section 19(2)(b) of the GIPC Law. Wholly foreign-owned enterprises must have paid-up capital of US$50,000.

Application to register a company is made directly or through agents or solicitors to the Registrar General. A company is duly registered after the company's regulations (ie, the constitutional documents) have been

submitted to the Registrar of Companies and a certificate of incorporation issued. A specified fee is paid on presentation of the regulations.

Investment incentives differ slightly depending on the law under which an investor operates. For example, while all investors operating under the Free Zone Act are entitled to a 10-year corporate tax holiday, investors operating under the GIPC Law are not automatically entitled to a tax holiday. Tax incentives vary depending on the sector in which the investor is operating. All investment-specific laws contain some incentives. The GIPC Law allows for import and tax exemptions for plant inputs, machinery and parts that are imported for the purpose of the investment. The Ghanaian tax system comprises tax concessions that considerably reduce the effective tax rate. The minimum incentives are specified in the GIPC Law and are not applied in an ad hoc or arbitrary manner. Once an investor has been registered under the GIPC Law, the investor is entitled to the incentives provided thereunder. The government has discretion to grant an investor additional customs duty exemptions and tax incentives beyond the minimum stated in the law.

Acquisitions and leases

18 Ownership and occupancy

Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

In Ghana, real estate ownership is categorised into two broad classes, customary land and public land. Customary land is land owned by stools or skins, families or clans usually held in trust by the chief or head of the family for the benefit of members of that group. Private ownership of real estate can be acquired by way of a grant, sale, gift or marriage. On the other hand, public lands are lands vested in the President for public use. Ownership is by way of outright purchase from customary landowners or private individuals or handed over by colonial governments.

The various interests in real estate in Ghana include the following:

- allodial title: highest interest in land, usually held by a community, stool, family or individual under customary law. It is held in such manner that the interest holder is under no restrictions on their rights of use or obligations in consequence of their holding other than any such restrictions or obligations imposed by the laws of Ghana generally;
- freehold title or customary freehold: an interest held by a member of the community or family, carved out of the allodial title. The holder of this interest holds rights of use subject only to such restrictions or obligations as may be imposed upon a subject of a stool or a member of a family who has taken possession of land of which the allodial owner either without consideration or on payment of a nominal consideration in the exercise of a right under customary law to the free use of that land. The 1992 Constitution, however, prohibits the creation of an interest in or right over any land in Ghana which vests in a non-citizen a freehold interest in any land in Ghana;
- leasehold: interest derived from the common law. There is therefore no customary law lease. It is an interest for a fixed term granted by a higher interest. In Ghana, the maximum period of a lease is 99 years and the minimum is one year. For non-citizens, the maximum term is 50 years;
- absolute conveyance;
- customary law tenancies; and
- proprietary interests (easements, profits, etc).

19 Pre-contract

Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

In Ghana, there are two main approaches to land purchase. These are the informal and formal approaches. The former is where there is no prior written contract between the vendor and purchaser and a conveyance is made transferring the vendor's interest in the land to the purchaser immediately after the parties orally agree on details such as the land to be sold, the price, the date of full payment of the purchase price, etc. This approach, although not safe, is the most popular in Ghana (*BJ Da Rocha*, 1999). If the vendor does not have an impeachable title such as that provided under PNDCL 152, a purchaser risks losing out on a transaction unless he or she is able to prove partial performance pursuant to the oral agreement to sell and purchase the land or to produce some documentation evidencing the agreement between them.

The formal approach is where the purchaser first enters into a written contract for the sale of the land with the vendor. Though the safer approach, this is the least used in Ghana.

Until a binding contract is entered into between the vendor and the purchaser, the purchaser is at liberty to sell to any person for valuable consideration. The parties' duties towards each arise only when a contract of sale in respect of a particular property is made.

20 Contract of sale

What are typical provisions in a contract of sale?

A contract for the sale of land consists of two main parts, namely the particulars and the conditions of sale or terms. The provisions in a contract of sale, in addition to the names of the parties, usually include the following:

- the physical description of the property, stating its character, where it is situated and its dimensions;
- the nature of the title or interest;
- any rights enjoyed by the property such as easements;
- encumbrances to which the property is subject and whether the property is to be sold subject to such encumbrances (eg, easements, restrictive covenants, mortgages);
- if the property is occupied by a tenant, the particulars of the tenancy especially the rent and duration;
- the price to be paid;
- any other terms the parties would want to govern their transaction;
- conditions of sale;
- title;
- vendor's capacity;
- deposit;
- requisition on title;
- preparation of conveyance by the purchaser;
- completion of sale date;
- vacant possession on completion of sale or purchase; and
- where required, special conditions of sale covering easements, restrictive covenants, etc.

Under an open contract of sale, the vendor is not entitled to demand the payment of a deposit or down payment from the purchaser. No part of the purchase price is payable until completion. On the other hand, in a formal contract of sale, the express conditions of sale may provide for a deposit of an amount, as is agreed on by the parties, to be paid by the purchaser on exchange of contracts. The deposit is treated as a security in respect of any loss the vendor may suffer because of the purchaser's failure to complete the sale.

A purchaser is required by the law to be given an abstract of title from the vendor. An abstract of title is a summary of all the documents, facts and events, which, taken together, show that the vendor has title to a property in question. An abstract is said to be perfect when it consists of a connected summary of a series of deeds, wills or other documents and material events within the statutory period that show that the vendor is able to convey the property agreed to be sold. Generally, a purchaser is entitled to a perfect abstract of title.

Ghana's legal system recognises and enforces secured interest in property. The process to obtain clear title over land can be quite lengthy. It is important to conduct a search at the Lands Commission and the Land Registry to ascertain the identity of the true owner of any land being offered for sale. The cost of the search is at the prospective buyer's expense.

21 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

This is seen more with commercial leases in respect of industrial property and operations than residential property. Environmental liability, obligations and restrictions would typically be in accordance with the Environmental Assessment Regulations 1999 (LI 1652) of the Environmental Protection Agency. The usual contract enforcement actions are applicable where a lease or contract making such relevant provisions is breached.

22 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

The seller has an obligation to disclose all facts that might influence the purchaser in its decision to purchase a property; particularly those facts that are not apparent to a person making a reasonably careful inspection of the property. Section 36(6) of the Conveyancing Decree empowers the sublessee or the assignee to call for and examine the instrument creating the term, however old. Accordingly, representations made by sellers of property regarding existing leases would typically include capacity to assign or create the sublease, performance and observance of covenants under the head lease.

Given that contractual duties and obligations of parties arise upon the completion of a contract of sale, the typical covenants made by sellers of property concerning leases between contract date and closing date would border on the positions of the purchaser and vendor. These include:

- the vendor as a constructive trustee for the purchaser;
- the vendor acquiring a lien on the property for the purchase money unpaid;
- the purchaser as beneficial owner in equity of the property contracted to be sold; and
- the purchaser acquiring an equitable lien on the property for any money paid to the vendor until a conveyance is made.

23 Leases and real estate security instruments

Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

The practice by lenders is to have the tenure of a security instrument subsumed under the term of a lease, so that a lease would at all times have some years on a security instrument. Therefore a foreclosure would not affect the unexpired term of the lease. A third party acquiring the interest under the foreclosure will thus have it subject to the terms of the lease.

24 Delivery of security deposits

What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

Rent is typically paid yearly in advance and is quoted on a monthly basis. More recently, however, some rents have been paid quarterly or biannually in advance. Generally a rental deposit equivalent to three months' rent is required. In instances where the tenant pays a year or more up front, there is usually no other deposit required. Rent reviews (usually upward reviews) are common in both residential and commercial leases.

25 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain a zoning report or legal opinion regarding legal use and occupancy?

PNDCL 152 provides that any person seeking any information concerning a parcel or interest in land may apply to the Land Registrar to inspect any register, sheet of the registry map of any instrument or plan filed in the Land Registry and containing such information on such days and during such hours and subject to such conditions as may be prescribed.

Any proprietor who acquires any land or an interest in land will be deemed to have had notice of every entry in the Land Registry that he or she was entitled to inspect at the time of acquisition. Accordingly, a potential acquirer should research the property in question to determine that it is not part of a communal trust or owed to someone else. Failure to obtain a land title could result in forfeiture of the property without monetary compensation. Usually potential purchasers of land would engage the services of lawyers to, among other things, prepare a legal opinion on the land in question. The legal opinion would focus on the validity of the vendor's title, land use as assigned by the town and country planning department of the respective metropolitan, municipal and district assemblies. In the absence of a lawyer, the potential purchaser would still have to ensure that the necessary checks, with the relevant agency or department, are undertaken.

26 Structural and environmental reviews

Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

Engineering and environmental reviews usually feature more prominently in large commercial or industrial developments and are less significant in respect of transactions for residential property. As such, environmental insurance is not common.

27 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

Lawyers usually review leases. One of the most important lease issues, particularly with regards to non-citizens, relates to the term of the lease. Non-citizens are not permitted by the Constitution to hold a lease exceeding 50 years at any one time. A lease created for a non-citizen exceeding 50 years at any one time is thus void. This constitutional limitation makes a renewal clause in a lease very important to a non-citizen who intends to hold the lease for a much longer period. It is noteworthy therefore that the option for renewal of the lease is jeopardised whenever there is a breach of a covenant by the lessee. If the breach is not fundamental, as in the case of non-payment of ground rent, it could be remedied by the issuance of two notices to pay. However failure to pay, following the notices, could lead to a forfeiture of the lease, under the appropriate circumstances. On the other hand, a fundamental breach such as non-development of the land leads to an automatic non-renewal.

Another issue worth pointing out to a client has to do with the requirement of a landlord's prior written consent in cases where the unexpired term of a lease is being assigned to a client. Generally, it is good practice for a lawyer to ensure that the assignor has duly performed all the covenants under the lease as of the time of assignment.

28 Other agreements

What other agreements does a lawyer customarily review?

A lawyer would customarily review all kinds of documents relating to land or an interest therein. The reviews are, however, subject to the

terms and conditions of the instrument creating a relationship between the parties concerned.

29 Closing preparations

How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

Preparations towards a closing would typically involve requisitions made by the purchaser's lawyer to the vendor or their lawyer. The vendor or their lawyer must give satisfactory answers to the requisitions raised before the intending purchaser or his or her lawyer proceeds to completion of the sale. In a formal contract for sale of land or an interest therein, the time for raising requisition on title is stated in the general conditions of sale. Even if time is of the essence, the omission by the intending purchaser to send in the requisitions within the stipulated time does not preclude the purchaser from subsequently submitting such requisitions, particularly where the prospective vendor has no title at all or he or she does not have the title he or she has contracted to convey to the intending purchaser. Under an open contract, requisitions must be raised within a reasonable time of delivery of the abstract of title by the vendor to the intending purchaser. The reasonable time is determined on a case-by-case basis.

The financing source would typically require, from the intending purchaser, a land title search report from the Lands Commission or the Land Title Registry as the case may be, a survey report, a valuation report and a legal opinion on the impending transaction.

30 Closing formalities

Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

For government lands, the conveyance of land or interest therein is subject to the prior written consent of the Lands Commission. This forms part of the recital of the deed of conveyance or any other relevant instrument duly created. Once the prior written consent of the Lands Commission is duly obtained, the signing of the contract is carried out between the purchaser and the vendor, witnessed by at least one person who must duly attest the execution by each party. There is no formal requirement for the signing to be done in a government office.

31 Contract breach

What are the remedies for breach of a contract to sell or finance real estate?

A purchaser can take direct action against the seller to hold the latter to the satisfactory performance of their contractual obligation and to obtain compensation from the seller for damage resulting from his or her default. Parties also have a right to rescind a contract for sale, particularly in cases where the parties make express provision that each party may rescind the contract on specified conditions as well as the consequences arising therefrom. Although a vendor may in some circumstances rescind a contract as a result of the requisitions made by the purchaser on the title, the vendor's refusal to comply with the requisitions must be reasonable. A vendor must act in good faith and reasonably. He or she cannot use the right of rescission in the contract arbitrarily to withdraw from a sale.

32 Breach of lease terms

What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply?

Tenants have the right to damages, specific performance and injunctive relief as well as the right to cure a default on the landlord's part at the landlord's expense.

Section 17 of the Rent Act 1963 sets the guidelines for the recovery of possession and eviction of tenants. The eviction is conditional on some stipulated circumstances existing.

Financing

33 Secured lending

Discuss the types of real estate security instruments available to lenders in your jurisdiction.

The real estate security instrument available is a mortgage. The Mortgages Decree 1972 defines a mortgage as a contract charging immoveable property as security for the due repayment of debt and any interest accruing thereon or for the performance of some other obligation for which it is given, in accordance with the terms of the contract. Thus, a mortgage in Ghana only operates as a charge on immoveable property; it does not operate to change the ownership right of possession or other interest in the property charged, except as provided by the decree.

Lenders distinguish between two types of mortgages, retail and individual mortgages and commercial mortgages.

For retail mortgages, the primary security is the property over which a security is charged and other property as the case may require. The mortgagor's salary, directors' guarantee and personal guarantee constitute secondary securities.

For commercial mortgages the lien is a primary security, while the assignment of receivables constitute secondary security.

Trust deeds are another form of security used. This is, however, applicable only where certain categories of investors come into a partnership. Investment banks use this instrument quite often. There are also contracts of suretyship or guarantee. These are governed by the Contracts Act 1960 (Act 25).

34 Leasehold financing

Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

Financing for leases of whatever tenure is available in Ghana, and it is not markedly different from absolute conveyances. Financing for either kind of transaction is characterised by lenders' due diligence and subsequent securitisation procedures.

35 Form of security

What is the method of creating and perfecting a security interest in real estate?

A security interest in real estate is perfected when it is registered with the appropriate agency following its due execution and attestation. Given the two systems of land records and registration in Ghana (see question 2), a security interest in real estate in an area declared a registration district would have to be registered at the Land Title Registry, under PNDCL 152, while a security interest in real estate in an unregistered district would have to be registered as a deed at the Deeds Registry by virtue of the operation of Act 122. The Companies Act 1963 (Act 179) requires that particulars of charges (mortgage, debenture, etc), created by companies, be registered with the Registrar of Companies.

Furthermore, pursuant to the Borrowers' and Lenders' Act 2008 (Act 773), charges and collateral created to secure credit facilities must be registered at the Collateral Registry within 28 days of the date of creation.

36 Valuation

Are third-party real estate appraisals required by lenders for their underwriting of loans? Must appraisers have specific qualifications?

This is dependent on the size and amount involved. For large projects, lenders will constitute a project implementation team comprising all stakeholders (ie, lenders, promoters, consultants and contractors and, where applicable, subcontractors). The choice of these consultants is not made by regular banks. However, investment banks, as strategic partners to such projects, may be involved in the selection of consultants.

There is also the practice whereby lenders have a list of recommended valuers that prospective purchasers would have to work with to produce a valuation report on a property in question. Alternatively,

Update and trends

As part of the public sector reform programmes and the Ghana Land Administration Project (LAP), Ghana's land administration and management system is currently undergoing some reforms aimed at enhancing the efficiency and effectiveness of the Lands Commission.

As part of the reforms, there has been a rebirth of the Lands Commission into an integrated corporate agency, comprising four distinct divisions, namely the Public and Vested Land Management Division (PVLMD), Survey and Mapping Division (SMD), Land Valuation Division (LVD) and the Land Registration Division (LRD).

The Lands Commission, with support from the Land Administration Project, has developed a strategy to re-engineer the commission's functions and work. The objective is to reduce the process time and transactional cost of land registrations while enhancing productivity, efficiency and transparency.

A major feature of the new set-up is the Clients Service and Access Unit (CSAU). The CSAU is the interface between the Lands Commission and its clients and the public in general, and is responsible for the provision of services including receipt of fees and charges payable for all land services, site plan preparation requests, assessment of stamp duty payable on instruments, lodgment of all land documents, searches, publications and certification.

It is hoped that the ongoing reforms will bring about the desired changes to Ghana's land administration system.

prospective purchasers may have the space to commission independent valuers to prepare a report for submission to potential lenders.

37 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

For such outlays and projects, the Bank of Ghana would have to give authorisation. The foreign country's central bank would have to approve such transactions as well. Ghana operates a source taxation system. As such the appropriate tax is paid on whatever is earned in Ghana.

38 Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

There are two types of interest rates, the local currency interest rate and the dollar interest rate. The local currency interest rate is benchmarked to the bank's base rate, while US dollar facilities have dollar base rates, though not in a standardised form. The standardised reference rates are the US prime and the LIBOR for the pricing of loans with several tenures. A loan that exceeds the reasonable rate is not attractive and potential borrowers are likely to go to another lender. Fees and lender costs are not included as interest for the calculation of an unreasonably high rate.

39 Loan default and enforcement

How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

The Borrowers and Lenders Act 2008 provides that where a borrower fails to pay an amount secured by a charge under the act, the lender may sue the borrower on any covenant to perform under the credit agreement, or realise the security in the property charged on notice to the person in possession of the property.

However, in practice, a judicial procedure is usually the last resort. Negotiations are often used to reach an agreement for payment rescheduling. This notwithstanding, where default is seen as deliberate, judicial procedures are used.

40 Loan deficiency claims

Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

Lenders are entitled to recover a money judgment. If primary securities are not enough then secondary securities will be resorted to where applicable. Regarding limitations, there are no limitations on the amount or method of calculation of the deficiency. The deficiency is simply calculated as the difference between the amount owed and the amount realised.

41 Protection of collateral

What actions can a lender take to protect its collateral until it has possession of the property?

The Borrowers and Lenders Act 2008 (Act 773) provides in section 33 that where a borrower fails to pay an amount secured by a charge under the act, the lender may sue the borrower on any covenant to perform under the credit agreement, or realise the security in the property charged on notice to the person in possession of the property. Section 34 of Act 773 further provides for the lender's right to possession in the event of a borrower's default. This section states that a lender is not obliged to initiate court proceedings in order to enforce the right of possession. Notwithstanding this, a lender would, according to practice, first seek a court order to go into possession of a property that is subject to a charge.

Section 29 of Act 773 provides for the concept of receivership. It states that a lender in whose favour a charge is created may either appoint a receiver or manager, or apply to court for the appointment of a receiver or manager to take possession of and protect the property, receive the rents and profits and discharge the outgoings of the property, or realise the security on behalf of the lender.

Similarly, the Mortgages Decree 1972 (NRCD 96) makes provision for the appointment of a receiver to manage the mortgaged property. Section 16(1) of the decree allows a mortgagee to apply to the court for the appointment of a receiver when there is a failure by the mortgagor to perform any act or obligation secured by the mortgage. Section 16(2) allows the receiver to take possession of the mortgaged property, collect income from the property, make repairs and do all things necessary for the proper management of the property.

42 Recourse

May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

Security documents would typically specify the assets of a borrower charged under a transaction. Recourse would thus be limited to the property or properties charged as security for a particular facility granted. If any guarantees were given as additional security, then recourse to guarantors' assets would apply. The extent of the guarantor's liability would depend on the type of guarantee given. A specific guarantee may be restricted to a particular facility while a continuing guarantee may extend to new facilities given.

43 Cash management and reserves

Is it typical to require a cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

Whether these are required would depend on the respective transactions. Where necessary, they would form part of the covenants made. Depending on the cash flows, a collection reserve account could be created for the purposes of providing a backup to the repayment account.

44 Credit enhancements

What other types of credit enhancements are common? What about forms of guarantee?

Credit enhancement such as letters of credit and guarantees are acceptable commercial instruments in Ghana. They are recognised and enforced by the courts of Ghana.

Generally, performance guarantees are enforceable by the Ghanaian courts. However, the success of enforcement of performance guarantees largely depends on the kind of guarantee executed. Where a performance guarantee is unconditional it is easier to enforce as the terms are clear and require payment on first demand. They are sometimes enforced by summary judgment because little or no issue arises. The enforcement of conditional guarantees becomes contentious where a prima facie case of fraud or mistake is raised.

Conditional guarantees, on the other hand, are more difficult to enforce as their enforcement is tied to stipulated conditions that more often than not would require a full trial to determine.

45 Loan covenants

What covenants are commonly required by the lender in loan documents?

Borrowers commonly covenant with lenders to repay the loan together with a simple interest at an agreed rate over a specified time frame according to an agreed payment schedule. Borrowers also covenant with lenders to repair and maintain the property, insure and keep insured at their own expense during the subsistence of the mortgage the property and its contents. Related to this, the lender is entitled to inspect the insurance policy and premium payments taken out by the borrower. Furthermore, although the Mortgages Act makes provision for a borrower to transfer all or any part of their interest in a mortgaged property, in practice lenders generally would require borrowers to covenant not to do so without the former's prior written consent or concurrence.

There are no significant differences between covenants in a freehold and leasehold financing agreements. The lender in either transaction seeks to ensure the repayment of the loan advanced to the borrower and in the case of a default, good security to fall back on.

46 Financial covenants

What are typical financial covenants required by lenders?

Financial covenants are usually based on the expected cash flows or the debt service coverage ratio. They include cash management and reserve systems, which provide a framework against which the lender assesses the borrower's ability to pay. Lenders could thus require borrowers to covenant to make available financial statements (usually quarterly) within a specified time frame.

47 Secured moveable (personal) property

What are the requirements for creation and perfection of a security interest in moveable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

A legal charge on moveable property, such as stocks and machinery, must be created by deed and registered at the Companies Registry.

48 Single purpose entity (SPE)

Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

Not applicable.

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India

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General

1 Legal system

How would you explain your jurisdiction's legal system to an investor?

The Indian legal system bears the influence of the English common law system, reliant on the value of binding precedent case law, ruling on equity and the principles of natural justice. Despite the influence of the English common law system, the Indian legal system has also incorporated elements of civil law, such as certain investigative powers of the judiciary relating to the institution of commissions of enquiry or questioning of witnesses. The judicial hierarchy flows upwards from the district or lower courts in every district or city to the High Courts in the states, all subject to the supervision and judgment of the apex court of India, the Supreme Court. Courts in India have wide-reaching powers. With respect to disputes pertaining to the transfer of immoveable property, the courts' powers extend to granting injunctions in accordance with the Civil Procedure Code 1908 (CPC) and ordering performance of contracts under the Special Relief Act 1963 (SRA).

Broadly, the key legislation governing real estate in India includes the Transfer of Property Act 1882 (TPA), the Indian Contract Act 1872 (Contract Act), the Registration Act 1908 (Registration Act), the Indian Stamp Act 1899 (Stamp Act) and the Indian Easements Act 1882 (Easements Act), in addition to various other legislation including the CPC, SRA and a gamut of state-specific laws. Foreign investment in the construction and development sector is additionally regulated by the Foreign Exchange Management Act 1999 (FEMA) and the rules, notifications and circulars issued thereunder and those issued by the Reserve Bank of India (RBI).

The Contract Act and the TPA permit oral agreements for transfer of property. However, the TPA also provides that any sale of immoveable property above 100 rupees requires a written agreement to be executed and be registered (under the Registration Act).

2 Land records

Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

In India, all real estate transactions involving the sale or conveyance or lease of immoveable property and land require registration of the definitive agreements or deeds such as the sale deed or conveyance deed and the lease deed, as the case may be. In a real estate transaction an agreement to sell or a memorandum of understanding or letter of intent (which provides for execution of a definitive agreement or deed at a later date) does not (ordinarily) require registration.

The law on registration of documents in India is contained in the Registration Act, which provides for compulsory registration of certain documents, while there are other situations where registration of documents is optional. For instance, registration of instruments of gift of property, leases of immoveable property from year to year, non-testamentary instruments such as deeds of exchange, a document assigning rents, sale of immoveable property, or trust deed evidencing interest in immoveable property with a value of 100 rupees or above, etc, is mandatory, while registration of wills, leases of immoveable property not exceeding one year or instruments evidencing interest in immoveable property of a value less than 100 rupees, etc, is optional.

If a document compulsorily required to be registered is not so registered, it cannot affect any immoveable property, confer any power to adopt or be received as evidence of any transaction affecting such property. A registered instrument over the same property would rank above an unregistered instrument covering the same property.

3 Registration and recording

What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

A document (conveyance or lease) required to be registered under Indian law needs to be executed before a government official, a registrar (appointed under the Registration Act), and the parties will have to appear before a registrar for authentication and registration of the document.

The registration of a document also involves payment of stamp duty and registration charges on the instrument recording the transfer of interest, the rates of which may vary from state to state. In some states, there are additional state-specific charges imposed, for instance, municipal charges or taxes, transfer charges, etc, payable to the concerned municipal authorities, development authorities, corporations, etc. Payment of stamp duty, if payable on any instrument or document, is mandatory notwithstanding registration of such instrument; thus registration is a check in that the registrar will not allow registration if an instrument or document is under-stamped or not properly stamped.

As per the Stamp Act, in the absence of any agreement to the contrary, with a sale or conveyance deed the purchaser is required to pay the stamp duty, and with a lease deed the lessee is liable to pay the stamp duty.

4 Foreign owners and tenants

What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

As a rule of thumb, foreign companies or foreign citizens are not allowed to directly buy or own real estate in India. A foreign company or foreign citizen may own shares in Indian companies, which may buy or own real estate or carry our construction development of real estate projects in India. The ability of such Indian company to buy or own will be subject to the business operations of such Indian company and the proposed usage of the real estate by such Indian company. An Indian company with foreign shareholding can own or take on lease any real estate for its business and operations. Further, the Consolidated FDI Policy 2016 (FDI Policy) issued under FEMA for foreign direct investment (FDI) in the construction development sector is set out below.

The exceptions to the rule of a direct ownership or buying of real estate by a foreign company or a foreign citizen are very limited. In accordance with the Foreign Exchange Management (Acquisition and Transfer of Immoveable Property in India) Regulations 2000 a foreign company having its branch office or other place of business in India (and which has been set up in accordance with the regulations framed under FEMA) may acquire immoveable property for carrying on its

business operations in India. For this purpose the foreign company is required to file certain declarations with the RBI as prescribed.

Further, non-resident Indians and persons of Indian origin are entitled to purchase and transfer immoveable property (excluding agricultural land) and make payment for this by funds received in India through normal banking channels by way of inward remittance from any place outside India or by debit to an NRE/FCNR (B)/NRO account.

5 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

A foreign company or individual can invest in the capital of an Indian company engaged in construction, development of townships, housing and built-up infrastructure. There used to be certain 'project area' and 'minimum capitalisation' requirements for FDI in the construction and development sector, but these requirements were done away with recently. Essentially, the Indian government, in its liberalisation spree, opened up this sector completely. Furthermore, 100 per cent FDI under the automatic route is also permitted in completed projects for the operation and management of townships, malls or shopping complexes and business centres. Consequent to foreign investment, transfer of ownership and control of the investee company from residents to non-residents is also permitted.

With respect to repatriation, the FDI Policy in relation to the construction and development sector states that the investor will be permitted to exit on completion of the project or after development of core infrastructure (ie roads, water supply, street lighting, drainage and sewerage). Further, as per the FDI Policy, the investor is permitted to exit and repatriate the foreign investment before the completion of the project provided that a lock-in period of three years, calculated with reference to each tranche of foreign investment, has been completed. Further, the transfer of a stake by one non-resident to another resident without repatriation of the investment is allowed and is neither subject to any lock- in period nor to any government approval.

It is pertinent to note that the exit restriction based on the progress of the project and the three-year lock-in period are not applicable for investments in hotels and tourist resorts, hospitals, special economic zones, educational institution, old age homes and investment by NRI.

6 Legal liability

What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

The owner of immoveable property typically bears the burden of payment of statutory taxes and levies under local state laws, for instance, property tax and other municipal taxes or charges. However, with respect to commercial properties granted on lease or license, the taxes may be contractually passed on to the lessee or licensee.

In addition, rights and liabilities of buyers and sellers of immoveable property are prescribed under the TPA. Customarily, while the seller is responsible for payment of statutory dues until the date of transfer of immoveable property, there are provisions in law that make the buyer or its lessee liable for non-payment of statutory dues by the seller prior to the effective date of transfer. Therefore, the need to conduct due diligence prior to acquisition of immoveable property arises.

Under a new Real Estate (Regulation and Development) Act 2016 (RERA), which was enacted on 25 March 2016, there are liabilities sought to be imposed on developers and promoters of real estate projects.

7 Protection against liability

How can owners protect themselves from liability and what types of insurance can they obtain?

At the outset, adequate due diligence conducted prior to acquisition of the property prevents the passage of undisclosed risks and liabilities to the buyer. Adequate indemnity obligations should be secured from the transferor of the property in this regard.

In India, insurance policies can be obtained for general as well as specific perils, for instance, fire, flood, earthquake, lightning, etc. Coverage may vary from one policy to another and one insurer to another. Public liability insurance may also be obtained by owners for other persons affected by any accident at the property or in connection thereto. However, there can still be third-party claims for environmental hazards resulting from the property or the usage thereof, which may not be covered under insurance, thereby providing sufficient scope for tortious claims and claims for damages by third parties and public interest litigation by public or environment-spirited citizens.

At present, title insurance is not very prevalent in India.

8 Choice of law

How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

Agreements and contracts pertaining to immoveable property are principally subject to the local courts where the property is situated and these are governed by Indian laws and local customs of the jurisdiction where the property is situated. However, the investment agreements under which foreign investment or FDI is made into construction development companies, the choice of law and dispute resolution forums are usually international forums such as the International Chamber of Commerce, Singapore International Arbitration Centre or London Court of International Arbitration, in addition to Indian arbitration.

9 Jurisdiction

Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

The CPC distinguishes between subject matter, territorial and pecuniary jurisdiction of civil courts. Accordingly, a court within whose limits the subject matter of a dispute is situated would have jurisdiction (section 16). In a situation where the immoveable property is situated within the jurisdiction of different courts, a suit can be instituted in any such civil court. However, the CPC also acknowledges that the jurisdiction of civil courts can be expressly (by statute) or impliedly barred (alternative remedy). Thus other forums, such as revenue courts, which have jurisdiction to entertain suits relating to rent, revenue or profits of land used for agricultural purposes under local land laws, can also adjudicate upon real estate-related disputes. With regard to immoveable property, the CPC provides that suits can be instituted for the purpose of recovery, partition, foreclosure, redemption, sale, compensation for wrongs and for the determination of any other right or interest in immoveable property. Thus persons who are adjudged to be necessary parties (Order 1, Rule 10, CPC) can institute a suit with respect to immoveable property. Furthermore, a court can join any other person as a party to such suit for immoveable property if the court is of the opinion that said person's presence is necessary for the complete adjudication of the dispute.

10 Commercial versus residential property

How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

The distinction between commercial and residential property does show in the master plan issued by the municipal authority of a city, whereby separate zones are earmarked for residential and commercial use. Alternatively, these are as per the development approval or licences obtained by a developer from the relevant authorities. Similarly, the Building Regulations and by-laws of various cities and states distinguish between residential, industrial, commercial, institutional properties, etc, and provide for different procedures with respect to each type of property. Further, varying rates of taxes and circle rates (the government-notified value of a property) are provided for residential and commercial property. While the circle rates of commercial and residential property may vary, the stamp duty rates remain constant.

11 Planning and land use

How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

The development and construction of real estate is governed by the Development Regulations, Building Regulations and by-laws and the respective master plan of a city or area of a state. A state government, usually, from time to time keeps enacting and enhancing its development plans for five or 10 years or a longer period. Appropriate development permission or planning permission is provided by state-appointed authorities within the local laws and development regulations. Local municipal authorities in urban areas are empowered to enforce compliances under applicable local laws for various aspects of development and construction, including permitted height of buildings, floor area ratio or floor space index that provides the basis for determining the maximum permissible floor area construction, water requirements, general building requirements such as distance from ancient monuments, eco-sensitive zones, etc. Construction cannot be undertaken until layout plans for the proposed construction prepared by a qualified architect in compliance with applicable laws are approved by the authorities concerned.

12 Government appropriation of real estate

Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

The Land Acquisition Act 1894 (Erstwhile LA Act) has been the paramount legislation governing acquisition of private property by the government. Provisions for acquisition of land are also found in other legislation including the Indian Forests Act 1927, the Metro Railway (Construction of Works) Act 1978, the National Highways Act 1956, the Petroleum and Minerals, Pipelines (Acquisition of Right of User in Land) Act 1962, etc, and other state-specific laws such as the Karnataka Industrial Areas Development Act 1966.

The Erstwhile LA Act has been replaced by the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act 2013 (LA Act) with effect from 1 January 2014. In terms of the LA Act, the compensation to be made to landowners has been increased to four times the market value of the land (in rural areas) and twice the market value of the land (in urban areas). In addition, under the LA Act, acquisition follows a far more detailed process that includes conducting a social impact study of the proposed acquisition, planning and taking steps for rehabilitation and resettlement of landowners, seeking the consent of landowners, etc.

13 Forfeiture

Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

Long-term leases and conveyances of the acquired lands granted by the government for a specified purpose allow for revocation of the lease or conveyance and seizure of the property by the government in the event of default by the lessee or transferee on payment of rent, consideration, municipal charges, taxes, usage of the property for any purpose other than for which it is leased, conveyed or acquired or for any illegal or immoral purpose, etc. However, such rights are not usually exercised without providing a cure period to the lessee or transferee to cure the said default. The length of such cure period depends on the terms of the lease or conveyance, and may differ on a case-by-case basis.

Other cases of forfeiture of property revolve around actions taken by the civil and criminal courts. The CPC empowers the courts to seize and attach property of a judgment debtor if he or she fails to satisfy a decree passed by a court. Similarly, the Code of Criminal Procedure 1973 authorises attachment of the property of an accused who fails to appear before the court despite service of summons to appear. Non-payment of statutory taxes and bankruptcy could also lead to attachment of property by the competent government authority or court of law.

14 Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency system in your jurisdiction.

The CPC provides that in the case of immoveable property, attachment can be made by an order prohibiting the judgment debtor from transferring or charging such immoveable property, and a prohibition on any person from taking any benefit from such transfer or charge (Order 21, Rule 54). However, the CPC also provides that immoveable property in the form of houses or buildings and land appurtenant thereto on which an agriculturist, labourer or domestic servant is residing cannot be attached (section 60).

There is new Bankruptcy Code, the Insolvency and Bankruptcy Code 2016, which is essentially the bankruptcy laws of India consolidating the existing framework by creating a single law for insolvency and bankruptcy.

Investment vehicles

15 Investment entities

What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

As mentioned in questions 4 and 5, under the FDI Policy investment can be made in the real estate development and construction sector and such investment can be made in the capital of a company incorporated in India. Accordingly, for a non-resident entity to invest in construction and development activity in India, the investment will be required to be made in companies. Investment in the real estate business is prohibited (ie, trading in or dealing in land, property, etc).

Further, non-resident entities can be incorporated as companies, as foreign portfolio investors or qualified foreign investors (to be able to invest in listed securities including listed debt securities such as non-convertible debentures or listed corporate bonds).

16 Foreign investors

What forms of entity do foreign investors customarily use in your jurisdiction?

The most prevalent entity formation for foreign investment is the private limited company. The other option now available, after recent amendments to the FDI Policy, is the limited liability partnership (LLP). In future LLPs will make up the most preferred option, considering that there are no restrictions on reduction of capital or buy-back of partners' equity.

17 Organisational formalities

What are the organisational formalities for creating the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

As mentioned above, the most viable form of investment is FDI into companies incorporated in India. Where the foreign investor proposes to set up a 100 per cent-owned Indian company, incorporation formalities under the Companies Act would need to be complied with and additional reporting requirements of the RBI would need to be made. Where a foreign investor is investing in an existing company or acquiring shares from an existing shareholder, the RBI would need to be informed by way of prescribed forms (such as FC-GPR for subscription of shares and FC-TRS for purchase of shares).

As mentioned above, LLPs are certainly more preferred owing to lack of restrictions on capital reduction or partners' equity buy-back; another advantage of the LLP is that there is no dividend distribution tax on distribution of profits to the shareholders as dividend.

Acquisitions and leases

18 Ownership and occupancy

Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

Indian law recognises multiple classes of interests in immoveable property ranging from a mere easement right created by prescription or by operation of custom, to freehold rights in the property conveyed through a registered sale or conveyance deed. Security interests in the nature of a mortgage or a charge may also be created to secure the payment of a debt or to secure the performance of certain obligations.

One of the rights that can be created is a licence right. A licence is a mere right to access or use an immoveable property for a limited purpose during limited hours. Under a typical leave and licence agreement, the licensor retains the constructive possession of the property while the actual possession may be transferred for a limited purpose and duration.

The next set of rights are those created under a lease registered with the sub-registrar having jurisdiction over the area in which the property is situated, wherein actual physical possession of the property is transferred to the lessee. Registration of leases beyond a period of 11 months is compulsory under the Registration Act. Further, leases may also be executed for longer periods, eg, in perpetuity or for 99 years, involving the grant of leasehold rights in a property, mostly by the government in consideration of a lump sum premium and payment of yearly rent. The rights created under such a lease are long-term leasehold rights (but not freehold).

While a registered lease operates as an effective transfer of leasehold rights in the property against the world at large, the most marketable and freely transferable interest may be created by transferring freehold rights in a property under a conveyance or sale deed, without reserving any rights thereunder. Government conveyances usually, however, do reserve certain rights for the government, for instance the rights to mines and minerals underneath the land comprised in the property, etc.

As far as attendant benefits and burdens on or attached to immoveable property such as easements are concerned, such interests can be passed on to the transferee if held by the transferor at the time of such transfer. For example, the easements, rents and profits arising out of the transferred land would vest with the transferee in terms of the TPA and the Easements Act. Practically, this would mean that if an individual were to acquire interest in an immoveable property to which a right of way is annexed, he or she would be entitled to enjoy the right of way along with the property for the duration of such transfer.

19 Pre-contract

Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

At the option of the parties, depending on the underlying intent of the transaction, non-binding agreements such as a term sheet or memorandum of understanding (MOU) or letter of intent (LOI) may be executed between the parties prior to execution of the definitive agreement, briefly detailing the commercial understanding of the prospective transaction and the rights and obligations of parties in respect thereof. Customarily, these documents are executed as an indication of the transferee's willingness to enter into the proposed transaction, subject to a satisfactory due diligence of the property to be acquired and completion of certain conditions precedent by the transferor. These documents may in some instances entail payment of a token amount as an advance payment towards the purchase consideration, which is adjustable in the final consideration payable and simultaneously operates as a motivation for the owner to part with the relevant documents pertaining to the property for conducting a due diligence.

In order to ensure that a term sheet, MOU or LOI is not binding on the parties it may be clarified in such document that the parties have mutually agreed to have no obligation under the term sheet, MOU or LOI, that the parties will negotiate in good faith and enter into a definitive agreement for the proposed purchase of the property and that such document is not intended to be a binding contract.

Other than brief highlights of the proposed transaction, the aforesaid documents may include clauses providing for exclusivity in dealings, confidentiality of the information, representations and warranties, conditions precedent to the signing of the definitive documents, due diligence, indemnity obligations, dispute resolution, etc. Generally, certain clauses such as exclusivity and confidentiality are specifically stated to be binding, while the others remain non-binding. Upon a dispute arising as to the binding nature of such term sheet, MOU or LOI, the court would usually seek to determine the intention of the parties, that is whether they intended such documents to be binding or non-binding. If certain provisions of the term sheet, MOU or LOI are stated to be binding, the court may also specifically examine if the provision to which the dispute relates was intended to be binding. If such term sheet, MOU or LOI is held to be binding and the parties have commenced performance thereunder, a possible consequence could be that the court decides that the term of the formal contract or definitive agreement drawn up later would be deemed to commence from the date of the said term sheet, MOU or LOI.

Generally, a customary binding contract for the sale and purchase of real estate in India is an agreement to sell (ATS) under which the parties agree to the basic terms for the transfer of the property and agree to enter into a sale deed for the proposed transfer.

20 Contract of sale

What are typical provisions in a contract of sale?

Like most contractual agreements, a sale deed would include details of the executants, recitals and background to the transaction, details of the property (usually property is demarcated on a map and a layout plan is annexed), details and manner of payment of sale consideration, respective obligations and liabilities of the parties with respect to taxes and charges attached to the property, restrictive covenants imposed on the parties, representations and warranties, etc, among other boilerplate clauses that include indemnity for breach or representations (or otherwise), dispute resolution, notices, etc.

In large transactions that involve fulfilment of numerous obligations post-execution of the definitive agreement, proceeds may be deposited in an escrow. However, the escrow mechanism is not very popular in real estate transactions and parties prefer to execute an ATS with payment of partial consideration, whereas the remaining consideration is paid upon fulfilment of the conditions precedent simultaneously with the execution of the sale deed, thereby concluding the transaction.

With regard to taxes, public charges, rent and other outgoings, the TPA and usually the sale deeds attribute liability on the seller for clearance of all dues and charges and assuming the risk of loss of the property till the effective date of transfer, after which the onus is shifted to the purchaser.

21 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

The concept of environmental clean-up has not fully evolved in India. However, judicial determination and review of acts of pollution through public interest litigation has led to the formulation of the 'polluter pays' principle, which renders the polluter liable for compensating the victims of the pollution and, to the extent possible, restoration of the environment in its natural form and taking corrective action to remedy the harm caused by its acts. Further, environmental aspects of real estate transactions fall within the purview of the environment laws of India such as the Environmental Protection Act 1986, the Air Prevention and Control of Pollution Act 1981, the Water Prevention and Control of Pollution Act 1974, the rules enacted thereunder, such

as the Hazardous Wastes (Management, Handling and Transboundary Movement) Rules 2008 and the notifications enacted thereunder.

The provisions of the Companies Act 2013 have mandated certain classes of companies to discharge corporate social responsibility, which includes activities relating to environmental protection and conservation.

22 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

Sellers need to make disclosure of all existing encumbrances on the property including existing leases. Usually with respect to existing leases, the rent received, the area of the premises leased out, the duration of the lease, the background of the lessee related to payment of rent including defaults by the lessee and the liabilities of the seller towards the lessee, if any, are disclosed and warranted against.

Between the date of the contract and the closing or between the execution of an ATS, LOI or MOU and the execution of a sale deed, the seller is restricted by covenants in the ATS, LOI or MOU not to create any further third-party right or encumbrance over the property without the consent of the intending buyer.

23 Leases and real estate security instruments

Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

If a lease is duly executed prior to the creation of a security interest over the property by the lessee, the lease would prevail over the security instrument, the secured creditor would be bound by such a lease and would need to wait until the expiry of the lease to enforce its security interest to sell the property. On the other hand, if the lease is created subsequent to a prior security interest, without the consent or knowledge of the secured creditor, the lease can be struck down and the tenant evicted (although eviction proceedings in India are long, drawn-out and complicated).

While under Indian law a security interest includes a mortgage, charge, hypothecation or assignment upon property created in favour of a secured creditor, a mortgage is the most common form of security interest created over immoveable property.

24 Delivery of security deposits

What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

It is very common for leases to entail payment of security deposits as a security against any damage caused to the property by the lessee during the lease period. Such security deposits are usually equivalent to three to six months' rent and may be adjustable against the rent due for the last months of the lease term. Rent revisions are usual but the rates are dependent upon commercial negotiations between the parties. The usual escalation (for most residential and commercial properties) is 10 to 15 per cent after every three years of the lease term.

Well-informed and advised buyers impress upon delivery (to them) of the security deposit received from the tenants, in cases where the buyers are aware of a prior lease over the premises.

25 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain a zoning report or legal opinion regarding legal use and occupancy?

The TPA places the onus on the buyer to verify the title of a property itself for which it may conduct a title search and due diligence and assure itself of the validity of the transferor's title to the property being transferred. The title search is usually conducted for a period of 30 years prior to the proposed transaction for which the due diligence is undertaken. Detailed due diligence can cover various aspects relating to the property, including the title flow, encumbrance check, zoning and permitted usage, construction related approvals and conformity with laws, litigation, etc. Furthermore, depending on the nature and complexities involved in the project, clients sometimes require the lawyers to provide clarity on the usage or zoning of the land.

The starting point of such a title search would be the appropriate sub-registrar's office where a register is maintained of all the non-testamentary documents executed and registered in relation to immoveable property situated within the jurisdiction of the said office. In addition to conducting a title diligence, it is ensured that the definitive agreements provide for all customary representations and warranties and sufficient indemnities for breach of the same.

As far as priority among interests is concerned, as discussed in question 3, the Registration Act gives precedence to registered documents pertaining to land or immoveable property over unregistered documents. Furthermore, the principle of nemo dat quod non habet applies, whereby no person can transfer a better title than he or she possesses themselves. Consequently, since the title of the seller is subject to the agreements in respect of the property previously registered, the title obtained by the buyer would similarly be so subject thereto.

26 Structural and environmental reviews

Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

As discussed in questions 6 and 21, real estate projects are subject to structural and environmental concerns. Engineering reviews are conducted by structural engineers and architects to verify that the building conforms to the structural safety norms and specifications and is constructed as per the approved plans and layouts. Representations and warranties (with or without corresponding indemnity) are usually obtained from the seller to the effect that the property is constructed as per the approved layout plans and all consents and approvals related thereto have been obtained. The scope of such representations and warranties may also include representations on such environmental clearances and approvals that were mandatory to be obtained under applicable laws. Similarly, occupancy and completion certificates issued by municipal bodies and local authorities require satisfaction as to structural safety, fire safety, hygienic and sanitary conditions, etc.

27 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

For short-term or low-value property leases, some clients prefer to follow standard formats provided by lawyers that are updated with the relevant commercial details by the business side and provided for final review to the lawyers. However, leases involving higher or longer commitments or complex transactions are generally prepared, reviewed and negotiated by lawyers. Usual causes of concern are related to representations and warranties of the parties, breaches and termination-related provisions, lock-in period, lease extensions and renewals, delivery of premises, payment of and securing the security deposit, registration and stamp duty implications, dispute resolution, etc. Property management and maintenance agreements are also negotiated and reviewed alongside the lease. They are coterminous agreements with the lease

deed, entail payment of nominal stamp duty and are not required to be registered. Lenders do require that any outflow of money with respect to any contract or understanding such as project management agreements, etc should be subservient to the financing security instruments.

28 Other agreements

What other agreements does a lawyer customarily review?

Other than title documents, lawyers review the LOI, MOU or ATS at the first stage, which are thereafter followed by a sale or lease deed. Depending on the magnitude and complexity of the transaction, an agreement for transfer of property may be coupled with numerous other agreements. A transfer of property such as a residential house between the owner of the house and a prospective buyer would involve a title search and review of the terms of transfer (consideration, encumbrances, compliance with local laws pertaining to rent, etc); whereas a transfer of immoveable property as between two corporate entities would involve more complex agreements (escrow arrangements where monetary consideration is flowing from one party to another, or a share purchase agreement, where the purchaser buys 100 per cent of the share capital of the company owning the immoveable property; agreements for setting up a special purpose vehicle solely for the purpose of acquiring immoveable property or for carrying out construction and development; powers of attorney (POA) executed to facilitate the buyer entity's post-transaction title requirements; etc). As far as development and construction of real estate properties are concerned a lawyer would be required to draft and review joint development agreements, collaboration agreements, development rights agreements, service contracts pertaining to supply of building materials, labour, etc.

29 Closing preparations

How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

Indian law permits executory consideration, that is payment and delivery taking place after the contract has been created, thus the timing of closing and funding can be determined by the parties to the transaction. Having said that, generally, there is no strict concept of closing of simple real estate transactions involving sale deeds and the same is usually accomplished by the parties by executing the deed by which the transfer is effected and having it registered at the relevant sub-registrar's office simultaneously to the payment of the consideration by the buyer and the delivery of original documents pertaining to the property by the seller.

The list of deliverables may vary depending on the nature of the entities involved in the transaction and also the nature of the transaction. For instance, in cases of acquisition of shares of a company owning immoveable property, the share certificates, corporate filings, statutory registers, share transfer forms and other corporate and secretarial documents would need to be handed over to the purchaser. Further, all transactions where the title is being transferred would involve delivery by the seller of original documents including the deed by which transfer of property is effected, title documents of the seller and the past owners, clearances and approvals obtained from appropriate authorities, mutation certificate, documents evidencing existence of encumbrances, authorisation by the board of directors if the seller is a company or a POA, etc.

30 Closing formalities

Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

With respect to transfer of immoveable property, the process of execution and registration of the deed of transfer in the presence of two witnesses at the concerned sub-registrar's office simultaneous to payment of the consideration constitutes closing in India. The parties may either be personally present or may authorise their lawful attorneys (authorised through registered POAs) or, in the case of a company, an individual (duly authorised by a board resolution) to execute the transfer deed on their behalf.

As noted above, transfer deeds are required to be executed along with stamp papers, e-stamp papers or franking (depending on the rules of the concerned state) of the requisite value (based on the stamp duty rates prevalent in the concerned state). Except in prescribed special circumstances, under the Registration Act registration of documents is required within four months of the execution of such document.

31 Contract breach

What are the remedies for breach of a contract to sell or finance real estate?

An agreement to sell immoveable property usually contains provisions to the effect that a breach by the buyer to pay the balance consideration would render the seller liable to forfeit the advance consideration paid under the agreement to sell. Further, an agreement to sell also customarily records provisions stipulating that a breach by the seller to deliver possession of the property when the purchaser is willing to perform its part of the obligations would make the seller liable for refund of the advance consideration with substantial interest or penalty (at times twice the amount advanced) or would entitle the buyer to compel specific performance under the agreement to sell. However, enforcing specific performance under the SRA has its own limitations and requires the plaintiff to show that monetary damages would not suffice to restore the plaintiff to his original position and a specific performance be ordered. A plaintiff can also seek injunction (temporary or perpetual) and avail of the inherent power of a civil court to grant any other such relief as the court deems fit.

Damages are usually granted under the Contract Act if the damage caused by the breach of contract is direct. Indirect, special and remote damages are not granted under Indian law. If the contract stipulates a penalty amount, then the plaintiff would be entitled to compensation exceeding up to the penalty amount depending, inter alia, on the quantum or excessiveness of the penalty amount. Under the TPA, in the case of a mortgage deed, at any time after the mortgage money has become due to the mortgagee and before a decree has been made for the redemption of the mortgaged property and the mortgagor has failed to pay the mortgage money, a mortgagee can obtain a decree from the court debarring the mortgagor from redeeming the mortgaged property, or for the sale of such property. Under special enactments such as the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (SARFAESI Act), on the failure of the borrower in repayment of the secured debt and the consequent classification of his account as a non-performing asset by the secured creditor, the secured creditor can initiate proceedings for enforcement of his or her security interest and taking possession of the secured assets, provided a notice is sent to the borrower to discharge the liability in full within the stipulated period and the borrower has failed to do so.

32 Breach of lease terms

What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply?

For a breach of the lease terms by the tenant, the landlord retains the right to terminate the lease deed in accordance with the terms contained therein and upon failure to vacate the premises, the lessor can seek eviction of the tenant. However, eviction is a cumbersome and tedious process in India and it may ordinarily take many years to evict a tenant, depending upon the location of the property and the courts having jurisdiction . On the other side, upon a breach of the covenants by the lessor and failure to rectify them, the lessee may, if the lease permits, serve a notice of termination on the lessor. In such cases the lessee also has a right get the same rectified at the lessee's cost and deduct such cost from the rents payable by the lessee or recover the same from the lessor.

The TPA expressly provides that a lease can be determined by forfeiture upon the breach of an express condition. In case such forfeiture relates to non-payment of rent, the lessee retains the right to seek relief against forfeiture at the time of hearing of a suit, by paying a sum equivalent to the rent and interest due along with the full cost of the

suit, or by providing such security that the court would deem fit. If the forfeiture results from the breach of an express condition, the lessor can enforce his or her rights against the lessee only after service of a notice and giving the lessee a chance to rectify the breach, if possible.

As far as special rules are concerned, different states have their own specific rent control legislation that takes precedence over the general law of the land in the case of a clash of provisions. For instance, under the Delhi Rent Control Act 1958, a tenant to whom the act applies cannot be evicted by a landlord unless the conditions specified in this legislation are satisfied, in addition to those specified in the TPA. In the case of a conflict of laws, however, the specific state law prevails over the general.

Financing

33 Secured lending

Discuss the types of real estate security instruments available to lenders in your jurisdiction.

Customarily, a mortgage is the most common form of security interest created over immoveable property. The TPA provides for different types of mortgage such as:

- simple mortgage: where the property is mortgaged without any delivery of possession, and upon failure to repay the loan the sale proceeds of the property may be appropriated towards the mortgage sum;
- mortgage by conditional sale: where the mortgagor ostensibly sells the mortgaged property to the mortgagee with a covenant that the mortgage would become void pursuant to payment of the mortgage sum;
- usufructuary mortgage: where possession of the mortgaged property is delivered to the mortgagee, who is authorised to retain the mortgaged property and receive rents and profits accruing therefrom;
- English mortgage: where the property is transferred absolutely to the mortgagee who will re-transfer the same to the mortgagor upon payment of the mortgage sum;
- mortgage by deposit of title deeds: where the mortgagor delivers the documents of title to immoveable property to the creditor with the intent to create a security thereon (this is only prevalent in certain states); and
- anomalous mortgage: none of the above forms of mortgage.

Other security instruments are pledges or hypothecation of moveables, which may form part of a real estate project, or escrow of project receivables, which are primarily most wanted owing to control over the cashflows of a project. In a self-liquidating project, cashflows are considered the best securities since the mortgage over the immoveable property keeps diminishing as the allotment or sale of units to third-party customers occurs.

In the recent past, real estate developers managed to make successful issuance of mortgaged-back securities to public and financial institutions.

34 Leasehold financing

Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

Ground leases in India are usually granted by state government instrumentalities and municipal authorities. These leases usually allow the lessees to obtain financing through pre-identified banks and lenders subject to receipt of a prior approval from the lessor. The lessee's lender in such a case acquires no better rights than the lessee itself. In case the borrower defaults in repayment of the secured debt, the lender bank only has the right to appropriate leasehold rights in the property to itself or its nominee, if the land is obtained by the borrower under a ground lease. This is because the rights of the lender would not ordinarily override the lessor's rights under the contractual documents executed. If, however, the borrower defaults in repayment in respect of funds secured against a charge over land owned by the borrower, the lender may appropriate the charged land to itself and may sell or encumber it to recover the amount due from the borrower.

In addition, lease rental discounting is also prevailing and obtained by the owners of the leased properties. These financing arrangements are on the basis of the lease rentals, lease tenures and other covenants of leases on a property.

Under applicable laws there is no minimum lease term for a lease being financed or a shorter maximum term for the financing and same dependent on the business decision of the lenders.

35 Form of security

What is the method of creating and perfecting a security interest in real estate?

See question 33.

36 Valuation

Are third-party real estate appraisals required by lenders for their underwriting of loans? Must appraisers have specific qualifications?

Valuation for transfer of real estate involves usually revolves around the benchmark of circle rates of the properties notified by the government (though the market rates could be significantly higher in certain jurisdictions). Real estate appraisers and valuation firms are used for valuation of properties in larger transactions where the value of the property is significantly higher than the circle rate therefor. These valuations can be on the basis of the net operating income from the property (if leased) or net present value of discounted free cash flow of a potential development on a property or replacement cost of the property or locational advantage of a property and the like.

37 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

Lenders from foreign jurisdictions are subject to the Master Circular on External Commercial Borrowings, issued by the RBI every year. This circular provides for certain conditions that must be satisfied by borrowers and lenders in case of the loan falling under the automatic route or the approval route. In the case of the automatic route, foreign lenders would have to supply a certificate of due diligence to the bank of the borrower in compliance with regulatory requirements to which the foreign lender is subject.

Another route that foreign lenders and investors use is through subscription of secured non-convertible debentures of Indian companies, which are then listed on a stock exchange in India. The security interest is created in favour of a debenture trustee, who is responsible for holding the security on behalf of the non-resident and also overseeing compliance by the borrower. The non-resident subscriber will have to be registered with the Securities and Exchange Board of India as a foreign portfolio investor.

38 Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

The interest rates are set on the basis of the interest rates set by Reserve Bank of India (the central bank). Interest rates are higher in India, since it is still a developing country and there is a high level of inflation. Consequently the interest rates for any loans or financing are high. Indian banks usually do not lend money for the acquisition of land; they do lend for construction of real estate projects. Loans are easily available for home buyers as well. The fees and lender costs are generally excluded from the interest and are charged separately.

Update and trends

Real Estate (Regulation and Development) Act 2016
The long-awaited Real Estate (Regulation and Development) Act 2016 (RERA) was enacted on 25 March 2016, and 69 sections of the RERA were notified by the Ministry of Housing and Urban Poverty Alleviation on 26 April 2016, with effect from 1 May 2016. The RERA has been enacted with the mandate of establishing a real estate regulatory authority (the Real Estate Authority), which will among other things regulate the Indian real estate sector and protect consumer interests in real estate transactions. The key methods through which the Real Estate Authority will uphold its mandate are:

- promoters must register real estate projects measuring more than 500 square metres or having more than eight apartments with the Real Estate Authority, and provide exhaustive disclosure pertaining to title, project plans, approvals, timelines for completion, etc, upon applying for registration; post-registration, issuing allotment letters, and respond to any subsequent demand by the Real Estate Authority for information pertaining to the same; and
- adjudication of among other things any breach of the statutory rights and obligations of promoters and consumers.

Foreign direct investment
The Department of Industrial Policy and Promotion, pursuant to press note No. 12 dated 24 November 2015 (the Press Note), amended paragraph 6.2.11 of the Consolidated Foreign Direct Investment Policy 2015 (2015 Policy) (which is now reflected in paragraph 5.2.10 of the Consolidated FDI Policy of 2016). Pursuant to the Press Note, the minimum area norms and minimum capitalisation norms have been removed. Non-resident investors are now permitted to exit and repatriate their foreign investment before the completion of the project subject to a lock-in period of three years, calculated with reference to each tranche of investment. Foreign investors are also permitted to transfer their stake to another non-resident, without repatriation irrespective of government approval or the above-mentioned lock-in period. Furthermore, 100 per cent FDI under the automatic route is permitted in completed projects for operation and management of townships, malls or shopping complexes and business centres. Consequent to foreign investment, transfer of ownership and control of the investee company from residents to non-residents is also permitted. However, transfer of immoveable property or part thereof is not permitted during the three-year lock-in-period.

Environmental legislation
The Ministry of Environment, Forest and Climate Changes has recently amended Notification No. SO1533(E) (the EC Notification) (which regulates the process of obtaining prior environmental clearances for construction and development projects meeting the specified thresholds of the EC Notification) (see Notification No. SO2944(E) dated 14 September 2016), thereby extending the validity of environmental clearances granted under the EC Notification from five to seven years.

39 Loan default and enforcement

How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

As mentioned in question 31, after a mortgage payment has become overdue, a mortgagee can institute proceedings to obtain a decree debarring the mortgagor from redeeming the mortgage property or for sale of the property. Similarly, in the case of a mortgage by way of conditional sale, default in payment of a loan would make a conditional sale absolute. In case a loan is secured by a security interest as defined in the SARFAESI Act, a secured creditor would have the option to enforce its security interest according to the procedure laid down in the SARFAESI Act, which is more expeditious than the usual civil court process. Upon receipt of a notice from the secured creditor the borrower is required to discharge its liability within the stipulated time frame, failing which the secure creditor would have the right to take possession of the secured assets of the borrower.

40 Loan deficiency claims

Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

Yes. There are no limitations. Indian law does not allow remote or indirect damages awards.

41 Protection of collateral

What actions can a lender take to protect its collateral until it has possession of the property?

Lenders usually take interim orders to protect the status quo on the property. Lenders also seek rent deposits or other income or revenue from the property to be deposited into a court-appointed receiver or escrow agent or a separate bank account. Further, TPA prescribes certain liabilities which the mortgagee in possession has to bear, such as:

- to manage the property as a person of ordinary prudence would manage it;
- to best endeavour to collect the rent and profits;
- to make repairs; and
- not to undertake any destructive activity, etc.

In the event of failure of a mortgagee in possession to comply with its responsibilities, when account is made pursuant to a decree of a court, such mortgagee must be debited with the loss, if any, occasioned by such failure.

42 Recourse

May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

Recourse is first available to the collateral; however, in a winding up, insolvency or other recovery proceedings initiated by a lender, the court can award recourse to all other assets of the borrower.

43 Cash management and reserves

Is it typical to require a cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

The lender typically takes charge over all cash flows of the borrower (or as agreed for security and collateral). These are created through hypothecation of the receivables along with escrow accounts agreements. It is not customary in India to maintain reserves for expenses; but in most cases the lenders require appropriate debt service cover reserves to be maintained in lending agreements.

44 Credit enhancements

What other types of credit enhancements are common? What about forms of guarantee?

Guarantees, including personal guarantees of promoters, are very common in India. In fact, lenders rely more on personal guarantees from promoters or key shareholders rather than a security offered by the borrower company, since promoters make every effort to ensure lenders are paid if the project does not perform. Depending on the negotiations,

suitable covenants can be built into a guarantee documents to protect the lenders in the event any mischief is created by the borrower.

45 Loan covenants

What covenants are commonly required by the lender in loan documents?

Usually there are negative and affirmative covenants in loan documents and additionally certain information covenants. Furthermore, with respect to the freehold and leasehold financing, among others things, one important covenant is in relation to maintaining the ownership of the property. In the freehold asset class ownership is already in favour of the borrower or owner, whereas with leasehold assets a covenant with the effect of maintaining leasehold ownership is provided.

46 Financial covenants

What are typical financial covenants required by lenders?

The most typical are security cover and the asset value, where periodic appraisals are conducted to keep the security enhanced if the value diminishes, and special rights requiring permission of the lender for any major actions of the borrower or its shareholders.

47 Secured moveable (personal) property

What are the requirements for creation and perfection of a security interest in moveable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

See above.

48 Single purpose entity (SPE)

Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

This varies on a case-by-case basis.

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General

1 Legal system

How would you explain your jurisdiction's legal system to an investor?

Japan is a civil law country with a unified court system. While the courts can exercise some discretion to achieve an equitable outcome, Japan does not have a separate equity court. Specific performance may be ordered by the court in a multitude of circumstances and pre-emptive injunctions are available. Oral contracts are valid in the same way as written contracts, generally the only difference being the relative difficulty in proving the existence of an oral contract in court. Parol evidence is generally admissible.

2 Land records

Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

Japan has a nationwide real property registration system for matters such as the conveyance of ownership or other rights over real property, with registration being required for that conveyance to be perfected.

Registration generally only has the power to perfect interests, and interests can be created without registration and the existence (or non-existence) of the registration of interests does not guarantee the existence (or non-existence) of interests.

3 Registration and recording

What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

For most matters that can be registered, the parties involved (for example, the seller and the purchaser) should jointly apply for registration.

Registration tax is payable at the time of the registration of the conveyance of ownership and is generally 2 per cent (currently temporarily reduced to 1.5 per cent for land conveyances) of the value of the conveyed real property. In addition, real property acquisition tax is payable, generally at a rate of 4 per cent (currently 3 per cent for land and residential buildings). As a matter of custom, registration tax and real property acquisition tax are typically borne by the purchaser. Reduced tax rates are available for certain types of real estate transactions. For example, a special purpose company (TMK) established under the Law Concerning Asset Liquidation is entitled to reduced tax rates provided certain criteria are satisfied. Further, in order to reduce transaction tax costs, it is common in commercial real estate transactions to place the real property in trust, and to thereafter transfer the rights to that real property in the form of a trust beneficiary interest. The registration tax for transferring the subject's real property to the trustee is 0.4 per cent of the value of the conveyed real property (currently temporarily reduced to 0.3 per cent for transfers of land to the trustee) and once the subject's real property is so entrusted, the registration tax payable upon a change of the beneficiary is only ¥1,000. Subsequent changes in beneficiaries will be similarly recorded in the real estate registry and the registration tax payable each time per property is ¥1,000. In general, real property acquisition taxes are not assessed on transfers through the trust arrangement.

4 Foreign owners and tenants

What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

Generally, there are no restrictions on foreign investors investing in, owning or leasing real property in Japan. There is a post facto reporting requirement that must be filed with the Ministry of Finance through the Bank of Japan for certain types of acquisitions by a non-resident of an ownership right or other rights in real property under the Foreign Exchange and Foreign Trade Law (the Foreign Exchange Law).

5 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

Other than the post facto reporting requirement under the Foreign Exchange Law (and possible fund-transfer restrictions aimed at money laundering prevention), generally there are no material exchange control issues in connection with a direct investment in Japanese real property by a non-resident.

6 Legal liability

What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

Generally the owner or tenant of real property may face tort liability if it wilfully or negligently acts or fails to act in breach of its duty of care in connection with the property and, as a result thereof, damage is sustained by a third party. Generally the lender on real estate is unlikely to face any tort liability in this kind of situation, as generally the lender would not have much control over the management of the property.

A person in possession of a building, tree or other structure on the land will be liable for any harmful property condition of such structures existing as a result of his or her negligence. If, however, such person in possession establishes that he or she has taken due care in preventing such property condition from causing harm to others, then the owner of the subject structures will be strictly liable instead. In Japan, the existence of asbestos in older buildings has become a major environmental problem. The concept of strict liability may apply in the case of damage caused due to the existence of asbestos inadequately maintained.

Environmental contamination of land is another major environmental concern. A landowner may be liable for damage resulting from environmental contamination caused by it or the former owners of the land.

It is standard for a seller to provide a warranty against defects to a purchaser in a contract of sale. In the case of a sale of real property from a professional seller (a licensed real estate broker) to a non-professional purchaser, the seller is statutorily required to provide a minimum of two years' defect warranty.

7 Protection against liability

How can owners protect themselves from liability and what types of insurance can they obtain?

A real property owner may obtain general liability insurance to insure against general liability claims brought against it. Insurance covering environmental liabilities, however, is extremely rare and cost-prohibitive. The only possible realistic protection available to an owner would be legal recourse against the previous owner of the subject real property. Such legal recourse would, for example, be available to the extent covered by environmental warranties in the relevant contract of sale and, unless expressly waived, would also be covered by a statutory warranty against defect. Recourse under tort law may also be available against any person responsible for the environmental problem.

8 Choice of law

How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

Choice of law in Japanese courts is governed by the General Law Regarding the Application of Laws, which provides that the governing law of a contract can be chosen by the contracting parties and generally such choice will be upheld by the Japanese courts. The law applicable to matters in relation to real property (such as the method of change of ownership and the perfection thereof) will be the law of the jurisdiction where the real property is located, which in the case of real property located in Japan will be Japanese law. Generally, contractual choice of law provisions are enforceable in Japan.

9 Jurisdiction

Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

The ordinary Japanese courts, which have subject-matter jurisdiction over most civil matters, have authority to hear cases and render decisions regarding disputes with respect to real property located in Japan. The parties necessary to an action will depend on the subject matter of the particular dispute. Generally the court will effect service within Japan by post. The appropriate method of out-of-jurisdiction service will depend on the terms of the relevant treaty entered into between Japan and the country of the other party. There is basically no requirement that a party be qualified to do business in Japan to enforce its rights and remedies in a Japanese court.

10 Commercial versus residential property

How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

Generally, there is no difference between commercial and residential properties with regard to real estate ownership, tenancy and financing, or the enforcement of those real estate interests.

11 Planning and land use

How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

The City Planning Law generally provides for rules on the use of the land. This law categorises the land into various zones and requires permits for certain developments of the land in certain zones and provides certain limitations on the use of the land and on the buildings that can be built in each zone.

Further, the Building Standard Law generally provides detailed rules on the buildings that can be constructed.

There are more laws that regulate and control matters that relate to real estate. Advice from lawyers or real estate agents should be sought for additional details.

12 Government appropriation of real estate

Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

The Land Expropriation Act provides rules regarding the compulsory purchase of real estate by the government, municipal governments and other authorities. Generally, a person who is expropriated of its rights would receive compensation, including the owners and tenants of the real estate and lenders with certain security rights over the real estate.

13 Forfeiture

Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

Real estate can be forfeited by an order of the court when it is related to, or a subject of, illegal activities.

14 Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency system in your jurisdiction.

There are several types of bankruptcy or insolvency proceedings in Japan. Bankruptcy and insolvency proceedings can be commenced either voluntarily or involuntarily. In the case of court proceedings, generally a bankruptcy trustee will be appointed. Although there is no automatic stay upon the filing of an application for bankruptcy in Japan, upon such filing, the bankruptcy court will normally issue a preliminary court order staying execution against the assets of the bankrupt borrower. Thereafter, once a bankruptcy proceeding has officially commenced, a stay against such execution will come into effect. Upon a seller's bankruptcy or insolvency, the seller's fraudulent conveyance can be voided (even if it is implemented before the bankruptcy) under certain statutory conditions.

Investment vehicles

15 Investment entities

What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

Various legal entities are used in real property transactions in Japan. Incorporated entities, such as a joint-stock companies (KKs), limited liability companies (GKs) and TMKs, which provide limited liability to their shareholders, are the most common. Foreign corporations are also recognised and can be used as investment entities by first registering their branch offices in Japan.

To achieve pass-through tax treatment, a silent partnership (TK) is commonly used. A TK is a two-party contractual arrangement between an operator (TK operator) and an investor (TK investor), pursuant to which the profits and losses of the silent partnership business (TK business) receive pass-through tax treatment in accordance with the TK agreement. In addition, a TMK can also constitute a tax pass-through entity (although only with respect to profits), if it satisfies certain criteria. The TMK arrangement is preferred by foreign investors because it is believed less likely that the Japanese tax authorities will challenge the legitimacy of the TMK's pass-through tax treatment. In the case of the TK arrangement, there exists a possibility that the Japanese tax authorities may challenge the pass-through tax treatment by recharacterising the TK as an ordinary partnership arrangement, which would result in the foreign investor being deemed to have a permanent establishment in Japan, thereby resulting in more taxes being imposed on

the foreign investor. A tax specialist should be consulted for details on the application of Japanese tax on these investment structures.

Shareholders of KKs, GKs and TMKs have limited liability. Further, a TK investor will have limited liability with respect to the TK business conducted by the TK operator. Among these alternatives, the TK arrangement may have a slight disadvantage in light of the possibility of being recharacterised as an ordinary partnership arrangement, which would result in the loss of limited liability.

16 Foreign investors

What forms of entity do foreign investors customarily use in your jurisdiction?

TK and TMK investment structures are commonly used by foreign investors.

17 Organisational formalities

What are the organisational formalities for creating the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

Roughly speaking, most forms of incorporated entities can be incorporated with nominal capital and relatively simple documentation (such as articles of incorporation), accompanied by registration in the corporate registry. A foreign entity operating its business continuously in Japan is required to register at least one individual to act as its representative in Japan, at least one of whom must reside in Japan. Corporate taxation of Japanese corporate entities and of branch offices of foreign companies are basically the same, except for the special tax pass-through arrangements mentioned above (those for TKs and TMKs).

Acquisitions and leases

18 Ownership and occupancy

Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

Ownership (absolute interest similar to fee simple interest) is the primary right in real estate. The holder of the ownership right will have the right to dispose of and use the real estate. Land and buildings are construed as different types of real estate and ownership of the land and ownership of buildings constructed on that land can be dealt with independently. Generally, there is no other type of ownership interest (such as leasehold rights given by the government for a limited time period) for real estate. Ownership interests can be transferred by contract and there is no requirement on the formality of the transfer instrument and theoretically it can be transferred by verbal agreement, although that is not typical for real estate transactions.

Co-ownership is the typical way to allow real estate to be owned by more than one person. The right of the co-owner extends to the entire real estate and not only to part of the real estate.

In order to allow land to be owned by more than one person without using co-ownership, the land can be subdivided into more than one lot and each person can become the owner of a particular lot of the land.

In order to allow a building to be owned by more than one person without using co-ownership, the owners can subdivide one building into condominium units (by satisfying certain conditions that each condominium unit would have certain independence from the others).

The typical way to provide a right to use the land or building is through a lease, which can be created by a contract. Generally there is no requirement regarding the formality of the lease contract except for certain types of leases that provide for fixed terms. A master lease structure is commonly used.

Generally, other types of benefits to, and burdens on, real estate are created by contract with the owner of the real estate.

19 Pre-contract

Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

With regard to the sale of real property of substantial value (eg, ¥100 million or more), it is common for the potential purchaser to submit a letter of intent to the seller before undertaking a comprehensive due diligence investigation and it is not common for the seller and potential purchaser to engage in negotiations over the term sheet for the contract of sale. Whether such letter of intent is binding will depend on its provisions. A letter of intent that is intended to be non-binding should expressly state that it is non-binding to ensure that a court will interpret it as such.

Customarily, sellers used to be reluctant to explicitly agree to take the subject property off the market while negotiating a definitive contract of sale. However, recently it became more common to give exclusivity and to take the property off the market before the execution of a binding agreement.

20 Contract of sale

What are typical provisions in a contract of sale?

A contract of sale typically includes a description of the real property to be sold, the sale price, date of closing and a warranty against defects. A typical contract of sale for commercial real property additionally includes seller's representations and warranties, closing conditions and seller's covenants.

In real property sale and purchase transactions, it is not unusual to require a 10 to 20 per cent deposit at the time the contract is entered into. Generally no escrow arrangement is used. The deposit will be forfeited if the transaction is cancelled by the purchaser without cause, and an amount equal to double the amount of the deposit must be paid by the seller to the purchaser if the transaction is cancelled by the seller without cause. Under Japanese law, it is difficult to obtain irrefutable evidence of good title to the property. Rights over real property must be registered in the real estate registry to be perfected; however, while the registry can serve as strong evidence of the existence of such registered rights, it does not serve as conclusive evidence. Accordingly, a purchaser will have to rely on the representations and warranties of the seller as to the quality of title to the conveyed property. The cost of the search of the real estate registry is borne by the purchaser, unless otherwise agreed.

21 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

The owner of contaminated land may be ordered by the relevant government authority to take appropriate measures to avoid any harm being caused to the neighbourhood by such contamination. When purchasing commercial real property, it is common for the purchaser to commission an environmental survey of the land, and generally the cost for such survey will be borne by the purchaser. If any contamination is found as a result of the survey, generally the seller will be responsible for the clean-up of such contamination.

Although it is common for commercial real property contracts of sale to contain representations regarding environmental matters, it is not common for future purchasers of the subject land to rely on representations made in past contracts of sale. In some cases, the purchaser is willing to rely on the results of the environmental survey and purchases the land on an as-is basis. In such cases, the seller will not be responsible for any contamination clean-up.

Clauses regarding long-term environmental liability and indemnity that survive the term of a contract are not common in Japan. Exceptions exist in the case of real estate securitisation contracts and other commercial deals, where comprehensive and detailed environmental representation and warranty provisions and defect warranty provisions that survive for a certain time after the closing may be commonly found. Japanese law does, however, provide for a post-closing statutory defect warranty, which although not mandatory and waivable by agreement under certain circumstances, is generally understood to cover environmental problems discovered after the closing.

If any environmental defect is discovered on a target real estate before the execution of a real estate sales contract, a purchaser usually requires a seller's covenant to cure that environmental defect before or after the closing, noting completion thereof as one of the closing conditions, or by setting that covenant as a post-closing obligation of the seller; or a price discount of the real estate, taking into consideration the environmental risks resulting therefrom while accepting that environmental defect. In the case of a breach of a contractual covenant by a party, the non-breaching party may assert a claim for damages, and also request specific performance, such as delivery of possession of the subject property (or alternatively, request termination of the contract of sale).

22 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

Typical representations made by sellers of real property regarding existing leases relate to, among other things, the major terms of such leases (such as the term of each lease and the rent, facility charges, and security deposits payable thereunder), the existence or non-existence of any default under such leases, the existence or non-existence of tenants experiencing financial difficulties, the existence or non-existence of tenants of an antisocial nature, the existence or non-existence of any disposal of rights under such leases (eg, the creation of pledge over the right to demand the return of the security deposit), the existence or non-existence of any requests by a tenant to reduce its rent or any other disputes with the tenants. For major leases, it is typical for the seller to covenant to not take any action in relation to such lease between the contract date and the closing date without the prior consent of the purchaser. However, for minor leases, such as lease agreements for residential condominiums, such a covenant from the seller is not usually provided as it is typical to leave matters concerning the operation of the property to the seller until the closing date as long as the property is operated in the ordinary course of business. Generally, representations and covenants do not cover brokerage agreements. Lease representations and covenants generally do not survive after the completion of the sale. Estoppel certificates from tenants are not customarily required as a condition to the obligation of the buyer to close under a contract of sale.

23 Leases and real estate security instruments

Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

Generally, a lease agreement will not provide for its subordination with regard to security instruments. Priority between a lease and a security instrument is determined according to the chronological order of perfection of such right over the real property. Generally the perfection of a right over real property is done by registration in the real estate registry. In addition to registration, a lease for land can be perfected where the lessee owns the building that is located on the leased land and the ownership of such building is registered in the real estate registry. Further, the lease of all or a part of a building can be perfected by delivering possession of the leased premises to the lessee. Most leases are not registered and are instead perfected using the latter alternative methods of perfection. If a lease has priority over a security instrument, the lease will survive, and be unaffected by, the foreclosure of the security instrument. It is not typical for a lender to require subordination and non-disturbance agreements from a lessee. Generally the business practices related to real estate leases and the statutes and legal framework to be applied to real estate leases are largely different from other commercial leases.

24 Delivery of security deposits

What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

Pursuant to Japanese case law, when ownership of real property is transferred to a buyer, all obligations under a perfected lease with respect to such real property (including the obligation to repay security deposits to existing tenants) are automatically transferred to the buyer. In order for a buyer to ensure delivery of all security deposits, it is common for the buyer to offset the amount of such tenants' security deposits against the purchase price. Generally, security deposits are paid in cash, not by letter of credit. Under most leases, security deposits are required to secure the tenant's performance of its obligations, such as its obligation to pay rent. It is common for residential leases to have a short term (one or two years) and to have rent reviews at the end of such term. Various rent review methods are used in the case of commercial leases.

25 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain a zoning report or legal opinion regarding legal use and occupancy?

As mentioned above, for a purchaser to perfect its ownership as against third parties, the transfer of ownership must be registered in the real estate registry. Although registration is not conclusive evidence of ownership, it is generally understood that the real estate registry serves as strong evidence of ownership. To perform a title search in Japan, one will typically order and examine a certified copy of the real estate registry. It is common to use the services of a real estate broker or a lawyer to assist in examining the certified copy of the real estate registry. For securitisation transactions, it is standard practice to have a lawyer perform a legal due diligence investigation. There is no practice relating to title insurance, legal title opinion or indemnity funds. Japan provides 'statutory priority' for recorded documents at the real estate registries (which are prepared for each of the real estate lots managed by governmental registration offices) in the sense that the real estate registry is based upon a 'race' registration system (ie, first in time, first in right priority), irrespective of contracts between the parties. This priority system, which relies on the real estate registry, applies to the order of priorities of various other interests with regard to the real estate. For securitisation transactions, it is also common to have the engineering review mentioned below to cover the legality of the structure, use and occupancy of the real estate.

26 Structural and environmental reviews

Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

It is common to arrange for an engineering and environmental review when acquiring high-value real property (eg, ¥1 billion or more in price), especially in the context of a securitisation transaction. An

engineering review will typically cover such matters as legal compliance with national and local codes and regulations related to building, construction and fire prevention, structural integrity, asbestos and soil contamination and other environmental matters, as well as other physical conditions of the building. When acquiring high-value real property, it is customary to obtain representations, warranties and indemnities in relation to legal compliance with applicable laws and regulations, engineering and environmental matters. It is extremely rare to purchase environmental insurance. It is not customary to obtain a legal opinion in relation to due diligence of real property.

27 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

It is common practice to have lawyers review leases in securitisation transactions or in important commercial lease transactions. In advising our foreign clients, we explain that the Land Lease and Building Lease Law is very favourable to lessees. For example, under this Law, subject to certain exceptions, the lessor is not permitted to refuse a lessee's request for lease-term renewal unless the lessor can demonstrate a justifiable reason for its refusal (under Japanese case law, the concept of justifiable reason has been construed very narrowly); and notwithstanding the express terms of its lease agreement, a lessee may, in principle, seek a court order reducing its lease rent (if it is unreasonably high), even in the middle of a current lease term. Disputes relating to commercial leases are not unusual. A lender will typically not object to a lease having priority over its mortgage; however, it is extremely unusual for a lender to permit a property management agreement or other management agreements to have priority over its mortgage.

28 Other agreements

What other agreements does a lawyer customarily review?

In commercial property transactions, in addition to the real property contract of sale itself, it is customary for lawyers to review a variety of other transaction-related documents, including a certified copy of the real estate registry, brokerage agreements, trust agreements (where the transaction will be accomplished by way of a transfer of a real estate trust beneficiary interest), asset management agreements (where the purchaser is a special purpose company requiring asset management services), TK agreements (where equity investments to purchaser are to be implemented through TK investments), property management agreements and other service contracts, and if applicable, debt financing-related agreements. Documents necessary for registering the transfer of title upon closing of sale are usually drafted by a judicial scrivener.

29 Closing preparations

How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

Lawyers are involved in closing high-value commercial real property transactions (including acquisition, leasing and financing transactions). In the case of a hard asset conveyance, the principal documents at closing will be:

- a purchase and sale agreement;
- the agreements listed in question 28;
- a property risk report (*jyu-setsu*, a statutorily required report from the seller to the purchaser explaining the material risks in relation to the target property);
- those required for registering the transfer of real property ownership, such as the *toki-shikibetsu-joho* (that is, documented proof of the seller's ownership of the subject property, possibly in the form of an officially stamped application for registration when the seller obtained ownership to the subject property); and
- power of attorney from both seller and buyer.

In the case of a transfer in the form of a real estate trust beneficiary interest, written consent from the trustee with a certified date stamp from a notary public will be the principal document. In a typical lease transaction, a lease agreement and a property risk report are delivered. A typical real estate securitisation transaction could involve over 100 closing documents (including lease documents, equity investor sponsor letters and borrower counsel's legal opinions).

Japanese parties usually use corporate seals to execute documents, with confirmation of due corporate authorisation being accomplished through confirmation that the proper corporate seal has been used.

As a debt finance advancement is usually necessary for sourcing a part of the real estate purchase price, and a lender or other debt finance provider always requires immediate perfection of its security interest over the purchased real estate upon advancement of its loan, the timing of the closing and funding must normally be simultaneous. It depends on the case (sometimes the contract and closing occur on the same date); however, the typical period between the contract and closing is one month, due to debt financing arrangements, preparations for acquisition and debt financing closing documents, etc.

30 Closing formalities

Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

Typically, a closing meeting for the transfer is held at the office of the purchaser's lender offering debt financing for part of the real estate acquisition price (ie, the purchaser's lender). At the meeting, the relevant parties (typically, the seller, the seller's lender, the purchaser, the purchaser's lender, a trust bank (in a real estate trust beneficiary interest transaction) and their respective legal counsel and a judicial scrivener) confirm the various acquisition and debt financing closing documents. After the confirmation of those documents, the purchase price is wired from the seller's bank account to the purchaser's bank account; then, documents for registering the cancellation of the security interests of the seller's lender and for registering the real estate title transfer to the purchaser are released to the purchaser. Application documents for those registrations as well as application documents for the registration of the security interests of the purchaser's lender are immediately filed with the relevant governmental office managing the real estate registry. Registration taxes levied on those registrations must be paid at the time of the registration applications.

31 Contract breach

What are the remedies for breach of a contract to sell or finance real estate?

In the case of a seller's breach of the contract, a purchaser is entitled to request a court order for specific performance (ie, an order to deliver the real estate title to the purchaser and to register the title transfer to the purchaser). In this case, the purchaser is entitled to claim compensation for damages and (instead of specific performance) to terminate the contract. In the case of a purchaser's breach of contract, the seller is entitled to claim payment of the purchase price (or terminate the contract) and claim compensation for damages. In the case of a borrower's material breach of the debt finance documents (including the borrower's misrepresentation or breach of any of its covenants under such documents), a lender is typically entitled to accelerate the maturity date of the debt, demand payment of default interest, and exercise its foreclosure rights under the mortgage(s) over the underlying real estate. Sometimes, a contract provides a monetary penalty payable by the breaching party, irrespective of the actual damage incurred by the non-breaching party. Japanese courts generally respect those monetary penalty clauses.

32 Breach of lease terms

What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply?

Upon breach of the terms of the lease by the tenants or landlords, the non-breaching landlords or tenants are entitled to claim compensation for damages against the breaching tenants or landlords. If the breach

is material, the non-breaching party is even entitled to terminate the lease. However, Japanese case law requires that the tenant's material breach must be substantial enough to destroy the trust between the landlord and the tenant for the landlord to terminate the lease for the tenant's material breach. In other words, Japanese courts tend to interpret landlords' rights to terminate the lease restrictively (irrespective of the wording of the contract) and are reluctant to affirm termination of leases due to minor breaches by tenants. For example, Japanese courts tend to require two to three months' worth of rent to be unpaid for a landlord to be able to terminate the lease for the tenant's failure to pay rent.

Financing

33 Secured lending

Discuss the types of real estate security instruments available to lenders in your jurisdiction.

Typical security instruments available to lenders in Japan are mortgages and revolving mortgages over real estate (in the case of hard asset transactions), and pledges over real estate trust beneficiary interests (in the case of real estate trust beneficiary interest transactions). Under these security instruments the lenders are granted certain rights similar to those rights held by holders of liens or charges. Historically, a defeasible conveyance over real estate that has been affirmed under Japanese case law has also been widely used for real estate security instruments. However, due to the lack of detailed written rules regarding defeasible conveyances, there remains uncertainty in the foreclosure, etc of defeasible conveyances. These days, the above-mentioned statutorily defined security instruments are more widely used.

34 Leasehold financing

Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

In Japan, the rights of lessees to ground leases are generally well protected by the Land Lease and Building Lease Law (see question 27); therefore, it is quite standard for financial institutions to grant debt financing to borrowers that are secured by mortgages over buildings located on leasehold land. Certainly, a ground lessee's transfer of its rights, interest and position in and under a ground lease typically requires consent from the landowner (ie, the lessor of the ground lease), and the landowner usually requires payment of a fee for such consent or may even refuse to give such consent. This can be a hurdle for the financial institution to overcome when it seeks to exercise its foreclosure rights under the mortgage over the building. However, in such a case the financial institution may petition a court for an order for consenting to the transfer of the ground lessee's rights, interest and position in and under a ground lease upon the foreclosure of such financial institution's mortgage over the building (and the court will usually issue such order subject to the payment of a certain amount, as a consent fee, to the landowner). Thus, this landowner consent requirement is not an insurmountable hurdle to prevent debt financing secured by mortgages over buildings located on leasehold land. As long as the ground lease is subject to the Land Lease and Building Lease Law and has the minimum term as provided for in this statute, financing would generally be available; however, if the ground lease is a lease that falls under some exceptions to the protection under this statute (such as a lease for temporary use), then it is unlikely that financing will be available.

35 Form of security

What is the method of creating and perfecting a security interest in real estate?

Mortgages and revolving mortgages are the typical methods for creating security interests over real property. They are perfected by registration in the relevant real estate registry. In the case where the transaction is accomplished by way of an acquisition of real estate trust beneficiary interests, a pledge is created over the real estate trust beneficiary interests, and such pledge is perfected by way of written consent of the trustee (with a certified date stamp by a notary public). Security interests over moveables are generally perfected by transfer of possession of the same to the secured party or registration. In order to create a pledge over a borrower's right to a bank account, the written consent (with a certified date stamp from a notary public) of the bank with which the bank account is maintained is required. Security interests can be created for some categories of intangible property (such as patents) and they are generally perfected through registration.

36 Valuation

Are third-party real estate appraisals required by lenders for their underwriting of loans? Must appraisers have specific qualifications?

Usually, lenders of real estate loans obtain third-party real estate appraisals to evaluate the underlying real estate. This is absolutely necessary in the case of real estate non-recourse loans (in Japan, real estate loans are generally recourse loans unless a specific non-recourse carve-out clause is provided in a loan document), where lenders will not have recourse to other assets of borrowers. Real estate appraisers must obtain a business licence from the government.

37 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

The mere making of a loan secured by collateral situated in Japan will not trigger any licensing requirements. However, a lender who makes loans as its business to residents of Japan are found to be engaging in the business of moneylending and thus, be subject to rules under the Money Lending Business Law and be required to register thereunder as a professional moneylender.

A mortgage or the revolving mortgage is usually granted by execution of an agreement between the lender and the borrower (who is the owner of the real property to be mortgaged). Initial registration of a mortgage or a revolving mortgage is subject to a substantial registration tax (basically 0.4 per cent of the amount of a secured loan in the case of a mortgage, or of the maximum amount of loan secured in the case of a revolving mortgage). A mortgage is typically assignable without the consent of the mortgagor or any other mortgagees, and a revolving mortgage is typically assignable with the consent of the mortgagor, but without the need for consent from any other mortgagees. The registration tax rate for the transfer of a registered mortgage or revolving mortgage will usually be 0.2 per cent. In the case of a pledge over a real estate trust beneficiary interest, no registration tax is applicable because it can be perfected with the trustee's consent without registration. Separate from registration tax, stamp duties are applicable to loan and bond documents signed by a borrower. However, the amount of stamp duties is small in comparison with the amount of registration tax and should not affect the lender's choice of a debt financing structure.

38 Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

Reference to TIBOR or LIBOR to determine a floating rate loan's interest rate is common. Interest rates established as a spread amount over LIBOR, TIBOR or central bank interest rate indexes are basically enforceable in Japan. However, interest rates over 15 per cent per year (where the principal amount of the loan is ¥1 million or more) are not enforceable. If a loan's interest rate exceeds 109.5 per cent (20 per cent in the case of a professional moneylender) per year, the lender will be subject to criminal sanction. Fees are generally considered a part of the interest, except for costs incurred in connection with the execution of a loan agreement and a loan repayment.

39 Loan default and enforcement

How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

Enforcement of a debtor's obligations under a loan agreement can be made through judicial proceedings. In the case of a mortgage or revolving mortgage, the loan collateral can be foreclosed upon through judicial proceedings. The loan agreement will typically specify what constitutes a 'foreclosure event', with default of a material loan agreement obligation typically serving as an event of default, and then grounds for loan acceleration and foreclosure. Although there will be some amount of variation from case to case, typically it will take from several months to more than a year to complete a mortgage or revolving mortgage foreclosure. A separate foreclosure action will have to be brought to realise on each type of collateral. Japan does not have a concept similar to the 'one-action' rule nor does it have a 'one at a time' rule (ie, a rule that prohibits a lender from bringing an action on a note or guarantee if the lender has commenced a foreclosure action against collateral securing the borrower's payment obligations under said note or guarantee, or which prohibits a lender from bringing an action on a note or guarantee simultaneously with the lender's filing of said foreclosure action), provided, however, that, once a lender's claim has been fully satisfied through the foreclosure of its lien on collateral securing the debtor's obligations under the note, such lender is required to suspend all other actions to collect on said note, to enforce obligations under a guarantee or otherwise.

40 Loan deficiency claims

Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

In Japan, real estate loans are generally recourse loans unless a specific non-recourse carve-out clause is provided in the loan documents. Lenders are generally entitled to recover (until the claim becomes unenforceable because of the statute of limitations) any deficiency between the outstanding loan balance (and permitted additions) and the amount recovered in the foreclosure from the borrower or guarantor (if any), except in cases of non-recourse loans that explicitly provide a non-recourse carve-out clause. In the case of recourse loans, upon default, lenders are entitled to either foreclose the security instruments and recover the deficiency separately from the borrower or guarantor, or request the full amount of payment owed by the borrower or guarantor without foreclosure. In the case of non-recourse loans, lenders are only entitled to foreclose the security instruments and are not entitled to recover deficiencies that are not recovered in the foreclosure. Under the Interest Regulation Act, the maximum amount of loan interest (applicable to both recourse and non-recourse loans) is restricted to about 15 per cent per annum of the loan principal (where the loan principal amount is ¥1 million or more). Any excessive amount of interest provided under the loan documents is not legally enforceable, and should be returned to the borrowers or guarantors even if they voluntarily paid that excessive amount.

41 Protection of collateral

What actions can a lender take to protect its collateral until it has possession of the property?

Generally, the lender will not have possession of the property unless the security agreement provides for the contractual right of the lender to obtain possession and make a private sale. In order for the mortgagee to collect rent during a foreclosure, the mortgagee must obtain a judicial order to appoint a receiver and have the receiver collect rent and distribute the rent as dividends or obtain a judicial order for the attachment of rent and require that the tenants of the mortgaged property pay their rent over to the mortgagee.

Update and trends

The Bank of Japan has introduced a negative interest rate policy, and investors seeking higher (or decent returns) are injecting funds into the real estate market. The real estate market is very active and attracting many investors, both domestic and foreign. Furthermore, expecting strong demand for accommodation for the Olympic Games to be held in Tokyo in 2020, development projects for hotels and other facilities are under way, and the volume of development projects is expected to increase.

A bill for a major amendment to the Civil Code of Japan was submitted to the Japanese Diet in 2015. This amendment bill is still subject to a resolution of the Diet and is likely to be implemented sometime in 2018. This bill is broadly intended to modernise the contracts part of the Civil Code and will have certain effects on real estate transactions. The primary intent of the bill is to incorporate the rules provided for by court precedents into express provisions in the statute and to update the provisions that were criticised as being out of date, such as a high fixed default interest rate of 5 per cent when the current base interest rate in Japan is close to zero per cent. We expect that this amendment bill will have some moderate impact on real estate practice and the documentation for real estate transactions.

42 Recourse

May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

Unless otherwise provided in the loan agreement, a lender will have recourse against all the assets of the borrower. Recourse loan agreements are typical. There is basically no difference between recourse and non-recourse security arrangements in a bankruptcy filing. Typically, a lender's recourse, as against a guarantor, will not be limited to an action forcing the guarantor into bankruptcy, an action foreclosing on the mortgaged property, or an action compelling the guarantor to obtain additional financing to protect said guarantor's interest in the mortgaged property or ownership interest in the borrower.

43 Cash management and reserves

Is it typical to require a cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

In the case of a non-recourse loan to a special purpose company, it is typical to require that a cash management system be established pursuant to which the borrower must establish and maintain reserves for various purposes (such as reserves for future interest payments, tax payments, insurance payments, return of tenant security deposits (tenant security deposits need to be returned to tenants upon termination of the leases), repair and maintenance costs) and to require the borrower to open an account at a lender bank to manage all cash flow of the borrower. It is relatively rare to require cash management systems and reserves for other types of loans.

44 Credit enhancements

What other types of credit enhancements are common? What about forms of guarantee?

With the exception of payment guarantees, it is relatively rare for a lender to obtain credit enhancements beyond mortgages and other security arrangements mentioned in the answers above. Letters of credit and holdbacks are not common in Japanese loan transactions. After the amendment to the Civil Code, which is expected to become effective in a few years, it is expected that a guarantee by a natural

person (as opposed to a company or other legal entities) to cover a loan or other obligations indebted for business will be generally void unless the guarantee agreement is notarised. Upon notarisation, the guarantor will be required to report details about the guarantor and the guarantee agreement to a public notary. Additionally, a revolving guarantee by a natural person will be required to set a maximum amount of such guarantee (unlimited revolving guarantee will be prohibited). On occasion, the equity sponsor to a special purpose company receiving a non-recourse loan will provide a recourse carve-back guarantee letter (a 'sponsor letter') to the lender with regard to 'bad boy acts'. Such recourse carve-back guarantee letters are generally considered enforceable. Use of completion guarantees in development transactions is relatively rare except for a constructor's completion guarantee in a project finance deal.

45 Loan covenants

What covenants are commonly required by the lender in loan documents?

In the case of a non-recourse loan, it is common to incorporate a set of covenants aimed at protecting the lender. Such covenants may include the borrower's obligation to maintain its bankruptcy remoteness status, to effect loan repayments through a predesignated cashflow waterfall, and to refrain from taking on additional debt or selling or otherwise disposing of the lender's collateral. Covenants in a recourse loan arrangement (typically corporate loans) are much more limited in scope and number. Covenants in loan documents are not generally different depending on asset classes.

46 Financial covenants

What are typical financial covenants required by lenders?

In the case of a non-recourse loan, it is common to incorporate a set of financial covenants, including loan-to-value ratio and debt service coverage ratio covenants. To effect such financial covenants, it is common to require that the borrower submit financial reports and update collateral appraisal reports periodically. The above-mentioned financial covenants are relatively rare in a recourse loan.

47 Secured moveable (personal) property

What are the requirements for creation and perfection of a security interest in moveable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

Typically, mortgages or revolving mortgages over real property in the case of hard asset financing transactions, and pledges over real property trust beneficiary interests in the case of trust beneficiary interest transactions, serve as the key security interests for lenders. In addition to these key security interests, sometimes security interests in moveable (personal) property assets, such as pledges over the furniture, fixtures and equipment and other moveable assets that are necessary or useful for real property operation are also provided to the lender. Pledges over the moveables are perfected by the transfer of possession to the lender or registration. No 'control' agreement is required for perfection.

48 Single purpose entity (SPE)

Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

In the case of a non-recourse loan, the lender will usually require that a borrower is an SPE. For this purpose, a limited liability company incorporated under the Companies Act, or a TMK, is typically used. Incorporation of these companies is neither difficult nor materially different from incorporation of the more standard forms of companies. However, in the case of a TMK, an asset liquidation plan must be submitted to the relevant local office of the Financial Services Agency. To achieve remoteness from influence of a bankrupt equity sponsor and asset manager, the non-recourse lender will commonly require the appointment of an independent director as well as an independent shareholder for the SPE. It is quite common for the non-recourse lender to require the independent director to submit a non-petition letter for the purpose of trying to preclude a bankruptcy filing; however, the enforceability of such a non-petition letter is arguable and has not been judicially tested in Japan.

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Mexico

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General

1 Legal system

How would you explain your jurisdiction's legal system to an investor?

Mexico has a civil law system. Thus, under the Mexican legal system, a party can obtain an order to prevent an action in the form of an interdict, suspension of the contested act or precautionary measures, which are analogous to the injunction in our legal system. Such measures may freeze the action to avoid further damage or loss.

Parol evidence does not exist in our legal system, but oral contracts are foreseen in Mexican legislation.

2 Land records

Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

The Mexican system for registration is the Public Registry of Property and Commerce, managed by the local government authority, in charge of registration of real estate ownership, transfers of real estate, liens and encumbrances and other relevant notes on the title of the property, among other things.

Depending on the local regulations, such registration may have constitutive or declarative effects; declarative means registration makes the transfer enforceable against third parties; transfer is perfected by the execution of the sale contract. An exception is the state of Quintana Roo.

Registration does guarantee title and priority in relation to third parties, for example, when an owner transfers real state to more than one purchaser, the recognised sale will be the first registered in the Public Registry, and in this case the subsequent purchasers are deemed bona fide buyers; however, the purchaser is protected by a statutory indemnity, through which the purchaser may be entitled to receive damages and compensation for loss of profit from the seller.

3 Registration and recording

What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

Legal requirements vary depending on local regulations, local codes or regulations that have their own restrictions or mandatory requirements for registration. Some standard requirements are:

- public deed of the sale agreement (fees depend on the amount of the transaction);
- evidence of payment of the income tax derived from the transaction;
- evidence of payment of the services bills of the real state (water, real state tax, etc);
- certificate of non-encumbrance; and
- payment of the registration fees.

Notary fees, costs, and taxes in connection with the sale are normally paid by the purchaser or as agreed by the parties, except for the income tax, which is paid by seller. Notary fees can be minimised on specific dates by using a programme called *jornada notarial*, and taxes can also be minimised pursuant to some specific cases in tax laws.

4 Foreign owners and tenants

What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

Pursuant to the Mexican Constitution and Foreign Investment Law, there are some restrictions imposed on non-resident entities and foreign individuals on acquiring real estate; there are no restrictions on leasing real estate.

Foreigners may obtain a permit from the Ministry of Foreign Affairs to acquire real estate properties in the Mexican jurisdiction outside the restricted zone, which is a strip of land 100km wide along Mexican land borders or 50km wide along Mexican coastlines.

Only resident entities may acquire real estate in the restricted zone (such entities may include foreign investment in equity), plus foreign individuals, as set forth below:

- If the acquisition of real estate is for non-residential purposes, a written notice addressed to the Ministry of Foreign Affairs regarding the acquisition will be sufficient.
- If the acquisition of real estate is for residential purposes, the entity or the foreigner may not be able to acquire such property, thus the acquisition can be done through a trust held by a financial institution as trustee and the owner of the real estate, where the company or the foreigner may act as beneficiary.

Business freedom for foreign investors is restricted as the Mexican government regulates foreign investment at several levels.

5 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

Pursuant to Mexican law, payment obligations in a foreign currency undertaken inside or outside Mexico must be paid in the equivalent Mexican currency, at the exchange rate in effect published by the central bank on the date of payment.

Regarding the repatriation of profits and capital, Mexican law does not establish exchange control provisions or specific regulations on the repatriation of profits to its home or any other jurisdiction.

6 Legal liability

What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

Owners, tenants or lenders may be subject to liability derived from any damage caused by their acts or negligence. In addition, all owners shall provide documents certifying legal and legitimate ownership of real estate, or otherwise they would be liable to any third party making a claim on the ownership of the real estate.

Any owner, tenant or lender that causes environmental damage can face administrative, civil and criminal liability. In this regard, fault liability is the general standard; however, in relation to real estate, strict liability applies only in cases involving hazardous waste and material and high-risk activities. Note that all environmental damage follows the real estate in case of any transfer of ownership of the real state, thus causing liability to subsequent owners and tenants.

There is no concept of tort liability under Mexican law. However, a 2014 judgement of the Supreme Court established liability for civil wrongdoing of a hotel for a short circuit that caused the death of a child. The intention of this judgment was to implement civil wrongdoing criteria to be applied as precedents in future cases.

7 Protection against liability

How can owners protect themselves from liability and what types of insurance can they obtain?

Owners responsible for high-risk activity are legally required to obtain environmental risk insurance. Likewise, developers of projects requiring environmental impact authorisations must obtain insurance in the following cases:

- if there is a risk of releasing polluting substances into the environment;
- when the projects are located near endangered species; and
- when the projects are located within natural protected areas.

8 Choice of law

How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

Pursuant to Mexican law, the applicable jurisdiction is the one governing in the place where the real estate is located.

9 Jurisdiction

Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

The applicable civil or commercial courts, depending on the nature of the controversy or the transaction, if chosen initially by the parties to the agreement, depend on the location of the real estate. Any party with legitimate interest can file a claim before the corresponding authorities; parties with equal actions may file a claim jointly; to initiate an action it is not necessary that all parties be present.

Notices to parties out of the jurisdiction of the court are made via warrants if made within Mexico; if the notices are made in a foreign country, such notices are made via letters rogatory. All notices during a procedure shall be made through a judicial authority; notices made personally by parties have no binding effect. A party's qualification is governed by federal law, so if any individual is not disqualified from doing business, measures can be enforced in the whole country.

10 Commercial versus residential property

How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

There is no real difference in law whether real estate is used for commercial or residential purposes. However, there can be different regulations depending on several factors:

- if those who execute the agreements are considered as businesses under commercial law;
- if the material object of the agreement is considered a 'commercial thing' under commercial law; or
- if the legal act is commercial under commercial law.

If the interest in real estate matches any of the above scenarios, it will be regulated under commercial law (including procedural matters), leaving civil law only as a supplementary function.

11 Planning and land use

How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

Restrictions on property may be imposed by authorities at the three levels of government.

Both states and municipalities are responsible for the approval of urban development plans and zoning within their respective jurisdictions. States must take into consideration the concerns of municipal authorities when drafting urban development plans.

States legislate on urban planning, development and land use, while municipalities are responsible for their enforcement. Thus land use authorisations and building licences are issued by municipal authorities in accordance with their own procedures and development plans.

12 Government appropriation of real estate

Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

Mexico does have a legal regime for the compulsory appropriation of real estate by the government. This regime must comply with requirements such as:

- there must be a public utility situation (for example, public services such as transport, schools, hospitals or public offices); and
- the appropriation must be done exactly according to law with compensation to the owner of an average commercial value of the appropriated real estate.

13 Forfeiture

Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

Buildings constructed without the required permits and authorisations may be closed and even demolished, especially in cases when structural damage poses a significant risk.

14 Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency system in your jurisdiction.

Bankruptcy in Mexico can be either filed by the business entity, one or more of its creditors or the Federal Public Prosecutor.

The bankruptcy proceeding can either be filed to try to make an agreement between the business and its creditors or to declare the company bankrupt.

If the bankruptcy proceeding is filed to declare the company bankrupt, all the company's goods are sold by an executor chosen by the Federal Institute of Specialists in Insolvency Procedures and the business's creditors get paid with the proceeds.

Investment vehicles

15 Investment entities

What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

The most common forms of entity to perform business in Mexico are the limited liability company, the stock company and the investment promotion stock company.

It is highly advisable to incorporate trusts, which in most cases are pass-through vehicles pursuant to tax legislation.

16 Foreign investors

What forms of entity do foreign investors customarily use in your jurisdiction?

The most common vehicles for foreign investors are business entities (particularly the limited liability company) and trust agreements.

17 Organisational formalities

What are the organisational formalities for creating the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

Formalities for incorporating the above-mentioned entities include:

(i) request authorisation from the Ministry of Economy to use a corporate name;
(ii) notarise the company's by-laws before a notary public.;
(iii) register the public deed before the Public Registry of Commerce;
(iv) file the registration at the Federal Taxpayer's Registry; and
(v) file the registration at the National Registry of Foreign Investment (if applicable).

Failure to comply with (i), (ii) and (iii) invalidates the incorporation; failure to comply with (v) results in monetary penalties.

The tax consequences depend on the foreign investor's country; Mexico has entered into 95 tax agreements with other countries.

The limited liability company is the most advantageous entity for tax matters.

Acquisitions and leases

18 Ownership and occupancy

Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

Legal ownership is evidenced by public deed whereby the transmission of ownership from a previous owner is notarised. See questions 2 and 3.

Leasehold is evidenced with the lease agreement entered into with the landlord: it is not customary to notarise these agreements or to register them. However, certain local regulations may require long-term leases to be registered.

Legal ownership grants the owner the right to sell, use and benefit from the real estate; leasehold grants the tenant the right to use and benefit from the property.

Burdens and benefits such as rights of way, easements, etc, are part of the property and both owner and tenant benefit from them. Such benefits and burdens are created from agreements with third parties or by legal dispositions and must be established in the public deed and be registered at the Public Registry of Property.

Condominium regimes and cooperative ownership are recognised by law and must be registered at the Public Registry of Property.

Mexican legislation provides for special treatment and a special law for condominium regimes.

Master leases are used for expansion of big industrial companies, but are not typical.

19 Pre-contract

Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

Customarily a letter of intent is used when the transaction has not yet been defined at all or is to be negotiated over a long period, and when there is some due diligence research to be undertaken first to decide whether to enter the transaction.

These kinds of agreements are not often approved by judicial authorities; however, Mexican law covers promissory agreements, by which seller and purchaser agree to enter into a future purchase agreement; this promissory agreement is binding on the parties and enforceable before judicial authorities. It is not customary to take the property off the market until the negotiations have been concluded.

20 Contract of sale

What are typical provisions in a contract of sale?

Typical provisions are:

- object of the contract;
- price;
- closing date and closing conditions;
- expenses and taxes;
- representations and warranties;
- penalties;
- indemnities; and
- jurisdiction

A typical down payment depends on the specific transaction.

The purchaser may request evidence of good title and a certificate of non-encumbrance of the real estate's title.

Payment for the certificate may be agreed by the parties. The general representations and warranties are that sellers have good and valid title of the purchased real estate and that it is free and clear of encumbrances, the real estate was legally acquired and is in compliance with laws and permits, among other things; also there is indemnity for eviction for the purchaser, in the event of any act or circumstance that prevents, deprives or limits the disposability, ownership, possession or use of the purchased real estate.

Each party is responsible for the fulfilling its corresponding tax obligations. The risk of loss until closing is on the seller, since once the sale is completed the purchaser assumes the risks of loss.

21 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

In cases involving soil pollution, owners are jointly responsible with the performers of high-risk activities before the environmental authorities for clean-up. Likewise, owners must allow clean-up actions within their property. In both cases, owners may sue the faulty party for the damage caused. However, clauses in an agreement may include obligations on each party for cleaning up the property and notifying the environmental authorities; as well as the obligation on the seller to provide a Phase I environmental study, in some cases a Phase II study may also be required following the results obtained in Phase I.

Environmental liability expires 12 years after the day the damage was caused.

22 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

Typical representations may include that the property is not subject to any other lease, usufruct or to any other agreement that may grant rights to any third parties. In the case of existing leases, sellers must indicate their existence and status, as in some local jurisdictions tenants may be entitled to a right of first refusal regarding the purchase of the property.

Typical covenants usually consist of the obligation that no amendments to any existing leases shall be made and no new leases shall be

entered into. Parties may also agree that the landlord shall complete all incomplete tenant improvement work. In addition, sellers shall notify current tenants of the sale and purchase of the property, as well as instructing them that all payments from the date of the transfer of ownership shall be made to the purchaser's account.

In Mexican practice it is not common to find brokerage agreements regarding lease agreements. However, lease agreements may survive after the property transfer has been completed if seller and purchaser agree that all lease agreements shall be assigned to the purchaser.

Estoppel certificates from tenants are not required as a condition.

23 Leases and real estate security instruments

Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

A lease is not generally subordinated to a security instrument; however, it is common to secure payment of rent by the issue of promissory notes.

Leases commonly survive any transfer of ownership of the real estate, whether judicial or not. In the case of judicial sales, the lease agreement shall have been executed more than 60 days prior to the transfer of ownership, otherwise the lease agreement may be terminated. In this regard, leases may survive security instruments upon foreclosure. Subordination and non-disturbance agreements are not common practice, but may be required.

Ground leases are not treated differently from other commercial leases with respect to subordination to security instruments.

24 Delivery of security deposits

What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

Tenant security deposits are usually delivered from seller to buyer upon assignment of the lease agreement. Security deposits may be in the form of letter of credit if agreed by the parties.

It is customary for landlords to request security deposits of a month's rent. Such deposits are refunded upon termination of the lease if the property is returned in good condition. Otherwise, security deposits would be used to perform repairs to the property, cover any outstanding payments or for any breach of the agreement.

25 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain a zoning report or legal opinion regarding legal use and occupancy?

The typical method of title search is through the Public Registry of Property and Commerce (or the National Agrarian Registry, in the case of agrarian real estate). If buyers want to protect themselves against bad title, they can obtain a certificate of non-encumbrance of the real estate's title.

Mexican law gives priority to titles that are recorded in the register; a registered title has higher legal force than one that is not. The time of registration is also relevant to any dispute, since whoever is first in time will have higher priority than the counterparty.

It is not customary to obtain a zoning report, but a legal opinion regarding use and occupancy is.

26 Structural and environmental reviews

Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

While there is no legal obligation to conduct reviews, environmental due diligence and Phase I and Phase II studies are common in large-scale projects. They provide the following benefits to purchasers and future owners:

- they are useful to determine the level of compliance with environmental regulations;
- they allow the purchaser to know if there is a future risk of environmental damage, even if there is full compliance with the applicable regulations; and
- they may be used as a negotiating tool regarding the value of the purchase operation.

Environmental insurance is usually unavailable except for waste management and high-risk activities.

27 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

Important issues to point out include: length of the lease, representations, renewal rights, conditions of payment, events of default and authority of the landlord regarding the property. Special attention is given to causes of early termination and how to perform notices to tenants.

Also, it is customary for business executives to review the lease agreements and provide a business point of view of the documents or any other matters that may arise.

Property management agreements are not common in Mexico.

28 Other agreements

What other agreements does a lawyer customarily review?

Lawyers normally review the following:

- loans;
- trusts;
- leases;
- collateral; and
- concessions.

29 Closing preparations

How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

Closing must meet the conditions foreseen in the contract including, but not limited to, delivery of:

- invoices;
- public instruments evidencing title;
- evidence of the seller's authorisation to enter into the agreement (if applicable);
- evidence of termination agreements regarding leases (if applicable);
- all documents evidencing tax credits;
- no-lien certificates; and
- legal opinion from seller's counsel regarding the existence of any pending claims or litigation.

Legal counsel usually verifies authorisation through shareholders' meeting minutes approving the transaction or by specific representations and warranties included in the contract.

There is no normal timescale between contract and closing, it depends on the nature of the transaction.

30 Closing formalities

Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

Transactions may be executed by the parties present or through their legal representatives; also transactions may be performed without the presence of a government representative.

However, in a transfer of real estate it is necessary for all parties to appear before a notary public.

31 Contract breach

What are the remedies for breach of a contract to sell or finance real estate?

It is common to include a non-compliance clause or a conventional penalty in the contract in the case of an event of default. Such event of default may give the purchaser the right to enforce the contract, claim for loss and damage or be entitled to receive the indemnities indicated in the conventional penalty clause.

32 Breach of lease terms

What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply?

All remedies depend on whether it is the tenant or landlord who performed the breach of the lease agreement. All remedies can have one of three purposes: termination of the agreement and claim for loss and damage; mandatory execution of the terms of the lease; or payment of a conventional penalty previously established in the agreement.

The customary procedure to evict a defaulting tenant consists in a special procedure in which the landlord claims the payment of outstanding rents; these payments may be claimed from notice of the lawsuit. There is no eviction procedure under which landlords can evict tenants without going to court.

General contract rules apply to lease agreements, as well as local lease rules established in the corresponding civil code of each state.

Financing

33 Secured lending

Discuss the types of real estate security instruments available to lenders in your jurisdiction.

Finance is normally raised by granting real estate as collateral through a mortgage or a security trust:

- mortgage: this grants the lender a preferential right over lenders with a personal guarantee (such as guarantors or bondsmen); or
- security trust: the settlor transfers title to real property in favour of a trustee to secure payment of secured obligations in favour of the lender as beneficiary. The settlor retains a secondary beneficial interest in the collateral so that on satisfaction of the secured obligations, legal title to the collateral reverts.

Such securities are created in a public deed and perfected by its registration in the public registry where the real estate is located.

34 Leasehold financing

Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

It is not common to finance leases in our jurisdiction.

35 Form of security

What is the method of creating and perfecting a security interest in real estate?

Several formalities must be complied with in connection with a mortgage or security trust:

- mortgage: this can be created by an agreement, but to be effective against third parties the mortgage agreement must be formalised before a notary public and registered in the public registry in the state where the real estate is located; or
- security trust: this must be established by the settlor transferring title of the real estate in favour of a trustee, for the benefit of the lender; this security must be formalised before a notary public and registered in the public registry.

36 Valuation

Are third-party real estate appraisals required by lenders for their underwriting of loans? Must appraisers have specific qualifications?

It is advisable to require a valuation from an independent appraiser, who must be certified as a real estate appraiser by the corresponding government authority.

It is advisable to choose and hire appraisers listed in the list of auxiliary surveyors of the local judicial courts.

37 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

It is common for lenders from other jurisdictions to grant loans secured by collateral in Mexico.

It is not necessary for foreign entities to be qualified or licensed to grant loans, provided that such activity cannot be offered to undetermined people or through the mass media; also, it is forbidden to request or obtain funds or resources on a common or professional basis, since these conditions are reserved to banking institutions.

Upon registration of the mortgage the parties shall pay the fees, which depend on the value of the real estate.

When assigning the mortgage it is necessary to register the assignment agreement at the Public Registry of Property, following the same procedure as when the mortgage was first granted.

The 'tax' to be paid for assignment of the security is the Public Registry of Property fee, which may be paid by the assignor or assignee as agreed.

38 Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

Interest rates are freely agreed by the parties depending on the risk of the borrower's default. Legal interest rate established by law is 6 per cent and the interest may not constitute an amount above the principal.

For business to succeed, the interest rates must be lower than the ones offered by banking institutions, which are set by the Bank of Mexico and other government institutions.

Interest rates can be as high as established by the parties without being extortionate or evidently detrimental to the other borrower.

Fees and lender costs are not included as interest rates.

39 Loan default and enforcement

How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

Remedies against a debtor are enforced through a judicial procedure. It is necessary to sue a debtor requesting the forced execution of the agreement or termination and the payment of losses and damages. After a procedure before the courts, it would be necessary to obtain a favourable judgement. Depending on the amount claimed, there may be a possibility to file an appeal, and thereafter an *amparo* procedure.

One action is not sufficient to realise all types of collateral; as in the case of a real estate guarantee, it must be a special procedure. With pledge agreements there is also be a different procedure. In the case of a joint obligor, the action must be performed along with the procedures previously mentioned, as it constitutes a personal obligation. Personal and real estate obligations may not be claimed jointly.

The time frame may vary from case to case, and depend the size of the claimed amount. If the amount is under 500,000 Mexican pesos approximately, the procedure takes between three and six months. Otherwise, the procedure takes between two and three years.

There are no restrictions on legal actions that may be brought by lenders, as they find their basis on any default. There is no one-action or one-at-a-time rule. As indicated above, personal and real obligation claims may not be undertaken in the same action, but different actions may be performed simultaneously.

40 Loan deficiency claims

Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

Lenders are entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure. However, such different recoveries must be claimed through different procedures. It depends on each case and the reason of the deficiency. If a judge has ruled on the grounds of the case, this will be a matter of res judicata, which will be the only limitation for a lender seeking a deficiency judgement, alongside a 10-year time limit.

41 Protection of collateral

What actions can a lender take to protect its collateral until it has possession of the property?

With a mortgage receivership falls on the debtor, who becomes a depositary of the property upon notification of a legal procedure against the debtor. However, a debtor may not be constituted as depositary in case it notifies its refusal and delivers material possession to the plaintiff or to the individual indicated by the court.

During foreclosure rents remain in the possession of the depositary, as well as any corresponding yields of the property. Such rents shall be collected by the lender until foreclose; collection is not permitted until the procedure has concluded.

The concept of mortgage in possession is not recognised.

There are no specific penalties, but note that the depositary is considered as the manager of the property and thus is held liable for any impairment or detriment to the property.

42 Recourse

May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

Security documents do not provide recourse to all of the assets of the borrower as each security is specific and only seizes the necessary assets to cover the amount claimed.

Recourses are typically limited to the collateral, as it may not cover all the assets. This does have significance in a bankruptcy or insolvency filing as in this case a lender would appear as a creditor with real guarantee and be able to collect payment before tax and common creditors.

Personal recourse to guarantors is limited to the assets included in the previously granted guarantee.

43 Cash management and reserves

Is it typical to require a cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

It is typical to require a cash management system. This requirement may be performed through a common cash management system or through the establishment of a trust, whereby the depositary bank would be deemed as trustee of such trust.

Reserves are usually required for several matters, depending on the needs of the lender. It is common to find reserves required for insurance and repairs, as well as payments and uncompleted tenant improvements.

44 Credit enhancements

What other types of credit enhancements are common? What about forms of guarantee?

Other types include letters of credit, holdbacks, bonds and various kinds of payment guarantees, among others. Guarantees of completion are typically given and usually required. All forms of guarantee shall be enforced before the corresponding court, which may be determined by law or agreed in the agreement. Payment guarantees are also common.

Usually such recourses are previously foreseen in the agreement, whereby parties may establish several provisions regarding 'bad boy' acts. However, Mexican law also establishes several commonly enforceable actions such as creditor's fraud, which occurs when a debtor carries out acts with the purpose of obstructing the execution of guarantees by the lender.

45 Loan covenants

What covenants are commonly required by the lender in loan documents?

Typical loan covenants include:

- reporting requirements;
- borrower shall maintain its existence in good standing;
- compliance with all applicable laws;
- borrower to perform, in a timely manner, all of its material obligations pursuant to all agreements to which the borrower is a party;
- inspection of any properties, books and records of the borrower;
- if applicable, borrowers shall obtain insurance coverage;
- to use the proceeds only for the purposes established in the corresponding clauses of the agreement; and
- not to impose any lien on any property related to the loan or its proceeds.

As leasehold financing is not common, different covenants may vary from case to case. However, they would not vary much from the ones indicated above.

The difference between asset classes consists in the following:

- equity or stocks;
- income;
- real estate; and
- commodities.

46 Financial covenants

What are typical financial covenants required by lenders?

Typical financial covenants include:

- reporting requirements;
- annual or quarterly financial statements;
- communications from auditors;
- reviews by the banking authority;
- borrowers shall keep accurate and complete financial books and records;
- borrowers shall provide appraisals before the granting the loan and, typically, each time the loan is restated; and
- financial ratios commonly based on debt-service coverage ratios – loan-to-value ratios may also be required but are not common.

47 Secured moveable (personal) property

What are the requirements for creation and perfection of a security interest in moveable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

The requirements depend on the value of such property and the type of security.

Each kind of security interest provides a specific threshold under which it is only necessary that security interests are granted in a written agreement. However, if the value is above that established in the threshold, it would be necessary to grant it in a public deed before a notary public and register it in the Public Registry of Commerce, the Sole Register for Moveable Guarantees or another special registry such as registration in the Institute of Industrial Property (in the case of pledged intellectual property).

48 Single purpose entity (SPE)

Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

It is not required that each borrower be an SPE. The requirements for creating an SPE consist of the following:

- incorporation of the SPE before a notary public;
- obtaining a tax identification number for the SPE;
- recording in the corresponding Public Registry of Commerce; and
- if applicable, recording the SPE in the National Registry of Foreign Investment (RNIE).

Depending on the type of SPE, the requirements to maintain it will vary, the most common being:

- annual approval of financial statements;
- approval of management report;
- approval of surveillance report;
- approval of managers' and examiners' fees;
- annual renewal and quarterly reports to the RNIE;
- day-to-day maintenance of corporate books; and
- due payment of taxes.

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Monaco

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General

1 Legal system

How would you explain your jurisdiction's legal system to an investor?

Monaco has a civil law system. Courts rule in law but equity must be observed during all courts proceedings.

Parties can obtain ex parte decisions concerning real estate (eg, provisional mortgage) or even injunctions (eg, deed or lease communication), but proceedings are essentially governed by the adversarial principle.

Parol is admissible evidence by testimony (rare) or affidavit, but any obligation over €1,140 must be evidenced in writing (with some exceptions). Electronic documents are admitted under certain conditions.

Oral contracts involving real estate (eg, lease agreement) are often admitted by the courts but their content can be difficult to evidence.

Except for real estate deeds signed before public notaries, lawyers can prepare and review any contract involving real estate (eg, undertakings or draft agreements, lease agreements, works contracts, etc).

2 Land records

Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

A public registry both registers and records, among other things, ownership deeds, mortgages, long-term leasehold (over nine years) and generally any real estate in rem rights.

Failure to record does not make the transaction or action void, but renders it unenforceable against third parties.

Registration does not fully guarantee title (eg, ownership can still be challenged by third parties before the courts within statutory limitations), but it guarantees priority ranking for a mortgage.

3 Registration and recording

What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

Registration fees or VAT (20 per cent) for sale of new buildings or leases (optional) are collected by the tax administration (directly or by the notary public) on most transactions involving real estate.

Registration fees rates, depending on the type of transaction, are basically:

- 8.5 per cent of the market value, for any sale of real estate, usufruct or company shares owning real estate in Monaco, when the beneficial owner is unknown to the tax administration;
- 5.5 per cent on the market value, for any sale of real estate, usufruct or company shares owning real estate in Monaco, when the beneficial owner has been declared by the tax administration; or
- 1 per cent on the amount of the rent plus rental cost, for the whole duration of the lease.

Registration fees or VAT are customarily paid by the purchaser or the tenant, and at latest:

- to the notary on the day of signature of the sale of real estate or foreign company shares;
- to the tax administration within one month following the signature of the sale of Monegasque company shares owning real estate; or
- to the tax administration within three months following the signing of the lease.

Failure to pay within the time limits makes the party responsible liable to the payment of a fine, extra fees or both.

4 Foreign owners and tenants

What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

Foreign owners or tenants can freely acquire or lease real estate in Monaco provided they are able to make contractual commitments to do so according to their national law.

Foreign owners must comply with anti-money laundering regulations when financing their acquisition and should take into account tax matters when purchasing real estate with a foreign legal entity.

Foreign tenants should take into consideration the permitted conditions of the residency card or administrative authorisation to carry out a professional activity in Monaco.

Both owners and tenants should also take in consideration that any foreign individual must be in possession of a passport with visa or authorisation to enter, travel around or settle in French territory in order to enter, travel around or settle in the Principality of Monaco.

5 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

Any foreign legal entity owning real estate in Monaco must appoint a professional representative and declare each year the name of its beneficial owner.

Any modification of the beneficial owner is subject to a 5.5 per cent registration fee on the basis of the market value of the real estate.

Failing to appoint a representative, declare the beneficial owner or pay tax is liable to the payment of a fine, extra fees or both.

6 Legal liability

What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

Owners are mainly liable for any violation of planning (eg, lack of planning permission) or environmental (eg, asbestos exposure) regulations. Such liabilities extend to subsequent owners (subject to statutory limitations).

Tenants are mainly liable for improper use or maintenance of the premises, or improper behaviour regarding neighbourhood.

Tort responsibility follows general civil law principles, except alleged tort responsibility:

- of the owner when the building falls into disrepair; and
- of the tenant for fire in the rented premises.

7 Protection against liability

How can owners protect themselves from liability and what types of insurance can they obtain?

Owners can limit liability towards their tenants by inserting specific clauses into the lease agreement.

Owners and tenants can obtain insurance covering the usual occupier's risks (eg, fire, flooding, etc).

Specific insurance benefiting an owner can cover the responsibility of all construction participants (architects, engineers, builders, etc).

8 Choice of law

How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

Monaco law is applicable only to real estate located in Monaco.

Contractual choice-of-law provisions might be admitted for contacts involving real estate located in Monaco depending on their purpose and stipulations, but are very unusual and would jeopardise insurance coverage.

9 Jurisdiction

Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

The Tribunal of First Instance and, subsequently, the Court of Appeal and the Court of Revision have subject-matter jurisdiction over real estate disputes.

The Arbitral Committee for Commercial Rent has jurisdiction over commercial owners' and tenants' disputes about commercial rent amounts or tenants' eviction indemnity rights.

Foreign parties must have or have elected domicile in Monaco to defend themselves before the courts or committee and can only be represented by a Monegasque lawyer.

10 Commercial versus residential property

How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

If a commercial activity has been in operation for at least three years on the premises, the owner would face commercial lease mandatory status. The commercial tenant would then be entitled, among other things, to have the lease renewed for an equal period at its end or to obtain payment of an eviction indemnity when the lease is terminated without valid or legitimate grounds.

Both commercial owners and tenants have, under certain conditions, a pre-emption right:

- the owner on the commercial activity operated in the premises when sold by the tenant,
- the tenant on the premises when sold by the owner.

For real estate built before 1 September 1948, residential owners shall face mandatory restrictions compelling them, among other things, to rent the premises to local tenants only, with a limited rent amount and for a six-year period with renewal right at the end. In the case of sale of such real estate, the Monaco state has a pre-emption right over the premises.

11 Planning and land use

How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

Planning and real estate use is strictly controlled and limited.

A zoning regime, limiting building density and height or protecting certain types of buildings against external changes, is established by sovereign ordinance.

Planning permission must be obtained, and the works checked by the public administration for external and even some internal works.

Authorisation voted by the general meeting of co-owners, or in certain circumstances given by the property management, must also be obtained when the premises and the planned works are covered by co-ownership regulations.

12 Government appropriation of real estate

Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

In addition to pre-emption rights (see question 10), the Monaco state can expropriate real estate for public utility reasons. Owners receive compensation for expropriation.

Tenants and lenders (provided they had taken out a mortgage to guarantee repayment of the loan) must make themselves known to city hall services to be entitled to compensation.

Compensation for expropriation is awarded by the Tribunal of First Instance following expert evidence, except in the case of agreement between the parties.

13 Forfeiture

Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

Any vacant property or property without owner or without heir is deemed to belong to the Monaco state.

The Monaco state cannot seize real estate for illegal activities, but criminal justice can still freeze or seize without compensation real estate belonging to a suspect or convicted criminal individual or company, real estate obtained by crime or infringement or real estate used to commit crime or infringement.

14 Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency system in your jurisdiction.

Bankruptcy or insolvency is declared by the Tribunal of First Instance at the debtor's request, on any creditor's writ of summons or by the tribunal itself, when the debtor is unable to settle its current liabilities with available assets.

The debtor's liabilities and assets are temporarily frozen for the Tribunal to evaluate such liabilities and decide whether a plan of settlement can be executed or the creditor's assets must be liquidated.

An administrator is appointed to assist the debtor in any act of administration or disposition of the assets. The administrator immediately registers a legal mortgage over the debtor's real estate.

Any mortgage taken over the debtor's real estate after the insolvency judgment is unenforceable against declared creditors. Former mortgages remain enforceable.

The debtor's real estate is liquidated following auction sale proceedings regulated by the Civil Procedure Code. The proceeds of sale are shared between creditors by rank of priority defined by legal provisions.

Investment vehicles

15 Investment entities

What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

Subject to the consequences of the choice of investment entity for real estate investment in Monaco from a tax perspective, ownership of real estate can take various forms (either a foreign form such as an offshore vehicle or a local form such as *société civile immobilière* (SCI – a specialist type of company that is constituted for the ownership and management of property)).

16 Foreign investors

What forms of entity do foreign investors customarily use in your jurisdiction?

Foreign investors used to use offshore companies to own real estate, but now might prefer a Monegasque civil company (except public limited company and limited partnership) to avoid annual declarations and professional representation fees (see question 5).

17 Organisational formalities

What are the organisational formalities for creating the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

Creating a local entity entails having a registered office in Monaco, signature of the articles of association and registration of the created entity in the appropriate public register (different for commercial or civil entities). Any foreign shareholder or manager of a local entity undertaking commercial or professional activities must obtain administrative authorisation.

Any local commercial company must report annually on the company general meeting's vote on the annual balance sheet, profit and loss account and management report. Failure to do so is subject to a fine.

Civil companies must maintain a balance sheet and profit and loss account and keep them at the registered office for five years. Failure to do so is subject to a fine, but civil companies are not subject to annual reporting, neither are foreign companies.

Using civil entities (except public limited company or limited partnership) for holding real estate is more advantageous for tax liability regarding transparency regulations. (See questions 3, 4 and 5.)

Acquisitions and leases

18 Ownership and occupancy

Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

The legal ownership categories are:

- full ownership: this can be divided into bare property and usufruct (the usufructuary only having the right to use the real estate, the bare owner having the right of disposal);
- undivided ownership (eg, between heirs): this requires unanimous agreement between the undivided owners for use or disposal of the real estate (sharing can be requested at any moment by any undivided owner unless there is agreement to the contrary); and
- co-ownership: this allows right of restricted private use of certain parts of the building (eg, apartment) and common use of others (eg, elevators, stairs, corridors).

The leasehold categories are:

- civil lease agreement: owner and tenant freely agree on the duration, price and specific conditions of use of the premises (except special protective status for habitation leases in buildings constructed before the 1 September 1948 – see question 10);
- commercial lease agreement: see question 10;
- construction lease agreement: the tenant is committed to build on the owner's property and to keep the buildings in good condition during the lease; the owner will benefit from improvements to its property at the end of the lease; and
- emphyteutic lease agreement: owner and tenant agree a long-term lease (18 to 99 years) giving rights in rem to the tenant, such as the right to take a mortgage.

Free occupancy may be considered as a loan for use, obliging the borrower to use the premises as a good pater familias and give them back after use (the lender being able to ask for restitution should he or she have an urgent or unexpected need of such premises).

19 Pre-contract

Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

Letters of intent or term sheets are not customarily used in Monaco.

Pre-contracts for real estate sale (more rarely for leases) are draft agreements or accepted offers, which are always binding agreements.

The property is not taken off the market while negotiating, but selling real estate under offer may give rise to liability to damages.

20 Contract of sale

What are typical provisions in a contract of sale?

The typical provisions in a contract of sale are:

- full identity of the seller and purchaser, including matrimonial status for individuals;
- full description of the real estate, mentioning easements or special status (eg, co-ownership) if applicable;
- history of the property over the previous 30 years at least;
- discharge of the guarantee against hidden defects (except seller's bad faith); and
- price.

A down payment of 10 per cent of the total price is customarily paid when signing the draft agreement and held in escrow by the public notary until signature of the notarised deed.

The deed registered by the notary evidences the good title of the property of the purchaser.

Tax (only registration fees or VAT) is paid by the purchaser.

21 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

Environmental liability for real estate is the responsibility of the current owner. Clauses regarding long-term environmental liability are not customary in sale contracts. Typical general covenants exclude guarantee for hidden defects; therefore, the purchaser could sue the seller for damages or cancellation of the sale only in the case of bad faith.

22 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

Real estate sellers usually make representations regarding the last receipt of payment of the lease and a statement concerning the absence of any pending or foreseen litigation with any of the tenants.

Prohibition on contracting new leases between the draft agreement and the final contract of sale is sometimes mentioned in the draft agreement, but contracting new leases in the meanwhile would probably allow the purchaser to disengage (depending on the stipulations in the draft agreement).

Brokerage agreements only engage the seller and usually do not survive after the sale is completed, except by contrary agreement.

Estoppel certificates from tenants are not customary.

23 Leases and real estate security instruments

Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

Leases are not subordinate to any security instrument.

24 Delivery of security deposits

What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

No specific steps ensure delivery of tenant security deposits to a buyer, but the notary drafting the deed is liable for lack of information concerning the existing leases and deposit that should be automatically transferred to the purchaser.

Deposits are very common in all types of lease and are sometimes replaced by bank guarantees.

Clauses usually provide an annual indexation of the lease in any type of lease. On top of annual indexation, the rent can be reviewed during an ongoing commercial lease after at least three years from the previous agreement on the rent, when the owner (more rarely the tenant) can prove that the rental value has changed because of a modification in the general economic conditions in Monaco or in the conditions affecting the activity operated in the premises.

25 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain a zoning report or legal opinion regarding legal use and occupancy?

The typical and customary method of title search is a request to the public registry of deeds and mortgages. Protection for acquirers against bad title essentially depends on the public registry's information.

Zoning reports about applicable planning regulations are not customary but can be requested, to an architect rather than a lawyer.

Legal opinions regarding legal use and occupancy, especially concerning mandatory protected status of tenants for certain types of buildings or occupancy, are more common.

26 Structural and environmental reviews

Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

No.

27 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

Lawyers do review, or even draft, commercial (rarely residential) leases when asked by their clients. Lawyers most usually point out or draft clauses avoiding or compensating commercial property, clauses concerning works authorised in premises and clauses spreading maintenance or repair obligations between owner and tenant.

28 Other agreements

What other agreements does a lawyer customarily review?

Lawyers customarily review real estate purchase offers or draft agreements, or even purchase deeds including client assistance for signature before a notary.

Lawyers also often review works contracts, including for example requirement specifications, subcontract agreements, etc.

Lawyers sometimes review real estate agency mandates and co-ownership general meeting minutes.

29 Closing preparations

How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

The closing of an acquisition of real estate is done by notaries, generally after the draft agreement: few documents are usually requested for closure (essentially power of attorney for signatures of the non-attending parties, bank transfer certificates for payment of the price and documents justifying the realisation of the suspensive conditions, if any).

Closing documents requested for signature of a lease agreement are: notary deed to evidence the owner's property, full identity documents evidencing both parties' civil and marital status, commercial registry certificate and articles of incorporation for companies.

Closing documents requested for financing real estate acquisition are usually: corporate documents, business plan, cashflow statement, insurance policies and legal opinions.

30 Closing formalities

Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

Parties can either attend personally or be represented by special mandate for the signing of a real estate sale, of a lease agreement or of a financing agreement. A real estate final sale contract must always be signed before a notary.

A lease or financing agreement can be signed by the parties themselves (usually with lawyer's assistance).

31 Contract breach

What are the remedies for breach of a contract to sell or finance real estate?

Parties to a real estate sale contract can, depending on the situation, cancel of enforce the sale, and in any situation claim for damages.

Update and trends

Environmental regulations are currently being discussed in the Monaco parliament.

32 Breach of lease terms

What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply?

Lease agreements usually contain a termination clause stipulating that the lease would be automatically terminated should the defaulting tenant not fulfil its obligations within the stipulated delay (usually from eight days to one month) after formal notice. When using the termination clause, the lease termination has still to be confirmed by interim court order, which also orders the eviction of the tenant.

The tenant can still claim for damages when the landlord does not fulfil its obligations according to the lease agreement.

In the absence of a termination clause in the lease agreement, any party evidencing the counterparty's default can request from the court termination of the lease, damages or both to remedy the consequences of the default.

Financing

33 Secured lending

Discuss the types of real estate security instruments available to lenders in your jurisdiction.

The usual guarantees granted in case of the acquisition of an asset are as follows:

- mortgage;
- lender privilege;
- assignment of insurance indemnity, guarantee of the holding company with a pledge over its shares in the purchaser company;
- subordination of loans granted to the borrower by another company in its group;
- pledge over borrower's bank accounts; and
- recourse against the borrower's shareholders.

34 Leasehold financing

Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

Financing is available to acquire commercial leasehold rights in Monaco (ground leases being extremely rare).

Such financing essentially differs from land ownership transactions as a mortgage cannot be taken on leasehold rights (except for emphyteutic leases), but is usually replaced by a pledge over the leasehold right and often additional personal securities taken on the acquiring entity.

35 Form of security

What is the method of creating and perfecting a security interest in real estate?

Security interests in real estate can be created either by common agreement, judgment or even by law. Most of them (eg, mortgage) must be registered to be enforceable.

36 Valuation

Are third-party real estate appraisals required by lenders for their underwriting of loans? Must appraisers have specific qualifications?

It is common for lenders to request appraisals. There is no specific qualification required for an appraiser (except being agreed by the lender).

37 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

Concerning banking operations, French banking restrictions (banking monopoly) apply in Monaco according to treaties between France and Monaco. Banking operations include credit operations. Banking operations cannot be conducted in Monaco by a non-authorised entity owing to the principle of banking monopoly. A lender wishing to conduct a credit operation in Monaco must be licensed accordingly. However, a foreign lender can conduct a credit operation in its own jurisdiction and secure the loan by collateral in Monaco.

38 Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

Interest rates on high-value property loans are commonly set with reference to EuriBOR. According to section 357 of the Monaco Criminal Code and to Sovereign Ordinance No. 2.271, as of January 2016 the following rates of interest reflect the market: 15.62 per cent a year for overdrafts for individuals and 6.42 per cent a year for overdrafts for business needs, 4.36 per cent a year for personal loans and 3.32 per cent for real estate loans. Note that if the interest rates are 50 per cent above the said market value of the interest rates, the lender may be fined or, in case of recidivism, imprisoned for one to six months.

39 Loan default and enforcement

How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

Realisation of collateral depends on the type of collateral concerned.

A mortgage (ie, the most common collateral in real estate transactions) must be realised through judicial proceedings, including auction sale followed by sale price distribution between creditors. Auction sale proceedings must start after a formal notice delivered by bailiff and last from a minimum of six months to a maximum of three years.

Several actions may be necessary to realise all types of collateral, the time frame depending on the type of collateral. Even though monetary default is most common, any major or stipulated default can bring a foreclosure proceeding (usually after expiry of a certain period following formal notice).

Legal action to realise collateral can be restricted or even cancelled by a judge considering its utility to obtain repayment of the debt.

40 Loan deficiency claims

Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

Lenders are entitled to recover a money judgment against a borrower or a guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure. The time limit may vary between two and five years.

41 Protection of collateral

What actions can a lender take to protect its collateral until it has possession of the property?

There is no concept of receivership under Monaco law.

42 Recourse

May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

Recourse is typically limited to the collateral. Bankruptcy leads to a suspension of recourse except for lenders seeking to enforce a mortgage.

43 Cash management and reserves

Is it typical to require a cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

It is not typical to require a cash management system.

44 Credit enhancements

What other types of credit enhancements are common? What about forms of guarantee?

Other than an undertaking to allocate funds deposited in a pledged bank account, it is not common to have other types of credit enhancements.

45 Loan covenants

What covenants are commonly required by the lender in loan documents?

This depends on the nature of the underlying acquisition, but the following covenants are basically required by a lender in a loan document:

- compliance with applicable status;
- binding obligations;
- non-conflict with other obligations;
- power and authority;
- authorisations;
- insolvency;
- no filing or stamp duty;
- deduction of tax;
- no default;
- no misleading information;
- budgets and financial statements;
- no proceedings pending or threatened;
- no breaches of law;
- taxation and social security;
- security and financial indebtedness:
- ranking;
- good title asset;
- no ownership;
- assignable receivables;
- ownership, disposal and condition of the property;
- acquisition documents;
- environmental matters; and
- insurance policies.

46 Financial covenants

What are typical financial covenants required by lenders?

The typical financial covenants are based on loan-to value ratios.

47 Secured moveable (personal) property

What are the requirements for creation and perfection of a security interest in moveable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

Security interests in moveable (personal) property can be created either by common agreement, judgment or even by law.

Pledge deeds on intangible assets must be notified to the debtor by bailiff. Commercial pledges necessitate the debtor's dispossession of the pledged asset.

Certain types of collateral (eg, on business capital or commercial leasehold) must be registered and notified to third parties (eg, lessors).

48 Single purpose entity (SPE)

Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

It is not required that each borrower be an SPE. This may happen depending on the structure of the loan. The basic SPE for a real estate financing acquisition is an SCI (see question 15), the incorporation of which is quite simple and fast.

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General

1 Legal system

How would you explain your jurisdiction's legal system to an investor?

The Nigerian legal system is derived from the common law system. Decisions of the court in any dispute are delivered based on the provisions of the Constitution of the Federal Republic of Nigeria 1999 (as amended); federal and state statutes as well as subsidiary legislation made pursuant to the statutes; decided cases; customary and Islamic laws (where applicable); and the received English law (as applicable).

The principal land legislation in Nigeria is the Land Use Act 1978. Other legislation applicable to real estate includes the Property and Conveyancing Law 1959, the Conveyancing Act 1881 and Property and Tenancy/Recovery of Premises Laws of the various states in Nigeria.

Transactions affecting land in Nigeria are required to be evidenced in writing and signed by the parties. Failure to comply with this requirement renders such a contract unenforceable. However, where the sale of land is under customary law, oral contracts not adequately evidenced in writing will be enforceable in appropriate circumstances, particularly under circumstances where there are sufficient acts of part-performance.

The remedies available in land-related matters include damages, rescission, rectification, cancellation as well as injunctive relief and, in appropriate cases, specific performance.

2 Land records

Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

Nigeria has systems for the registration of title and other interests in real estate.

The law requires that any transaction or instrument that confers, vests, transfers, limits, charges or extinguishes any interest or right in any property must be registered. Transactions relating to the transfer of title or creation of a security interest in land are registered at the relevant lands registry. In addition, where a corporate body creates a charge or mortgage over its real property, the documents creating the security interest is required to be registered at the Corporate Affairs Commission (CAC) within 90 days of its execution.

Unregistered title to real estate only confers equitable interest while the interest of the creditor under an unregistered security is subordinated to that of a creditor under a registered security interests in the event of an enforcement of the security created.

3 Registration and recording

What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

Although the specific requirements may vary slightly depending on the state where the property is located, generally the process for registration or recording conveyances, leases and real estate security interests in Nigeria is done in three stages, namely obtaining the governor's or minister's consent to the transaction, stamping and registration of the document. The consent of the governor is required for properties within a state; the consent of the Minister of the Federal Capital Territory (FCT) is required for properties in the FCT; and the consent of the Minister in Charge of Lands and Housing is required for properties in Nigeria with title documents issued by the federal government.

An application for the consent of the governor or minister is submitted to the relevant lands registry together with documents that include a certified true copy of the title document of the property; four to six copies of the deed of assignment/transfer/conveyance/lease/sub-lease (depending on the name of the document) with survey plans attached; photograph of the property; current tax clearance certificates of the parties; and land form 1C (applicable to Lagos state). The consent of the governor or minister is granted upon satisfactory review of the documents. Upon obtaining the relevant consent, the documents are stamped at the Stamp Duties Office and then registered at the applicable lands registry.

Where a mortgage is created by a corporate body, the same is also registered at the CAC.

4 Foreign owners and tenants

What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

Transfer of ownership in real estate requires the consent of the governor of the state where the land is situated. In the same vein, the consent of the governor will be required for non-resident entities and non-Nigerians to own real estate in Nigeria. However, such consent would not be required for leases or any other interest in land for a term less than three years.

In Lagos state, a non-Nigerian is required under the Acquisition of Lands by Alien Law 1971 to obtain the prior approval of the governor in writing. However, the practice is for foreign nationals to acquire real estate in Nigeria using companies incorporated in Nigeria. A company incorporated in Nigeria (whether or not the shareholders are Nigerians) is a Nigerian company under the law.

5 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

Non-resident investors seeking to invest in real estate in Nigeria are required to inflow their foreign currency through an authorised dealer and obtain a certificate of capital importation (CCI) for the inflow. The foreign currency is converted into naira and invested in real estate in Nigeria. The CCI allows the investor to repatriate proceeds of the investment or capital gains through authorised channels.

6 Legal liability

What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

Owners and tenants face some liabilities as a result of laws or practice. Owners bear the liability of ensuring that the property is structurally sound and for taxes and charges over the property such as tenement rates or land use charges. In practice, tenants are generally not allowed to sub-lease but may do so in some cases with the prior consent of the landlord. It is customary for tenants to be liable to pay for all utilities and outgoings except those specified by law to be payable by the landlord. In well-structured leases, tenants will be liable to foot the cost of specific repairs in the property of damage done while the tenant is in possession of the property. These repairs are typically paid for from the security deposits made by the tenant at the time of paying the rent.

In Nigeria, there is the tort principle of occupier's liability, which imposes a duty of care on occupiers of land towards persons entering into the property for the purposes of a contract with the occupier; persons who are invitees such as customers who come to shop in the premises; licensees who come into the premises with the occupier's express or implied warranty; and trespassers who come into the premises (or remain there) without the occupier's permission or consent.

The courts have defined occupier to mean the original owner, tenants, subsequent owners, foreclosing lenders or anyone who has sufficient degree of control of the premises.

The degree of control will be sufficient if it is such that the person in question ought to realise that a failure on his or her part to take care may result in injury to persons coming into the premises.

7 Protection against liability

How can owners protect themselves from liability and what types of insurance can they obtain?

Owners can protect themselves from liability by maintaining insurance, including homeowners' insurance to cover damage or loss to the property. Owners can also maintain public liability insurance to cover bodily injury or death of third parties and accidental damage to property.

In the event that the property owner is an employer and there are employees working on the premises, the owner may maintain an employee compensation insurance to cover any injury resulting in death or disability of its employees in the course of their duties.

8 Choice of law

How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

Land and property transactions in Nigeria are governed by the laws of the Federal Republic of Nigeria.

The general principle is that the contract for sale of property is subject to the law of the place where the property is situated. Thus Nigerian law will apply to land and properties in Nigeria even where the parties are domiciled in jurisdictions outside Nigeria.

9 Jurisdiction

Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

The Customary Court, magistrates' court and state High Court have jurisdiction over real estate disputes in Nigeria. The Customary Court has jurisdiction where the land has a customary right of occupancy granted in its favour or deemed granted by a local government including matters for the declaration of title to a customary right of occupancy. Depending on the provisions of the magistrates' courts law of the state, a magistrates' court has jurisdiction in proceedings for the recovery of rent not exceeding 10 million naira. The state High Court has unlimited jurisdiction in respect of matters relating to any land where a statutory right of occupancy has been granted or deemed granted by the governor including matters for declaration of title, trespass to land or property and for recovery of rent where the sum exceeds the jurisdictional limit of the magistrates' court.

Before a claim can proceed in a court in Nigeria, parties directly involved in the cause of action and those who need to be made parties in order to be bound by the decision of the court are joined as parties to the suit.

For service of court processes outside the jurisdiction where the property is situated, the party seeking to effect service must apply for leave of court to issue the processes and serve same outside jurisdiction and for substituted service stating how the process would be served. Court processes can be served outside Nigeria upon obtaining the leave of the court. Such processes are served through substituted means, either through diplomatic channels or the foreign judicial authority. In some circumstances, a judge may direct that courier be used by the party effecting such service.

Parties need not be qualified or incorporated to do business in Nigeria before they can enforce remedies in Nigeria. It is, however, expected that offshore entities seeking to enforce remedies should retain the services of a solicitor qualified to practise law in Nigeria.

10 Commercial versus residential property

How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

Under Nigerian law, there are no separate provisions for enforcement of interests between commercial and residential properties regarding real estate ownership, tenancy and financing.

11 Planning and land use

How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

In Nigeria there are controls and limits on development, construction and use of real estate. A permit or approval from the appropriate physical planning or development control authority is required before construction, development or remodelling of any property can commence. Such permits and approvals are issued based on the prevailing zoning regimes.

Each state in Nigeria has laws that govern urban planning and regional development. Such laws make provisions for the issuance of building approval and development permits, and empower the relevant authorities to determine the zoning regime for the different cities, towns and streets in the state. The zoning regime, among other things, stipulates the land use, height restrictions, rights of way and applicable setbacks as well as the population density (in some circumstances). The zoning regime is reviewed periodically.

12 Government appropriation of real estate

Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

Nigerian law allows for the compulsory acquisition of land by the government on grounds that it is required for public purposes or for breach of terms and conditions contained in a certificate of occupancy.

In the event of a compulsory acquisition by the government compensation is payable to property owners. The compensation may be monetary or resettlement in a new location in lieu of compensation.

13 Forfeiture

Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

Certain laws in Nigeria empower the government to compulsorily acquire real estate without compensation. Under the Economic and Financial Crimes Commission (Establishment) Act 2002, persons convicted of money laundering, economic and financial crimes are liable to forfeit to the government without compensation real estate acquired with the proceeds of such offences.

14 Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency system in your jurisdiction.

In Nigeria, bankruptcy and insolvency are governed by the Bankruptcy Act Cap B2 Laws of the Federation of Nigeria 2004 and the Companies and Allied Matters Act, Cap C20 Laws of the Federation of Nigeria 2004 (CAMA) respectively. Individuals are declared bankrupt when they are unable to pay debts owed to creditors. On the other hand, a corporate entity is declared insolvent where it is unable to pay its debts.

There are two types of bankruptcy proceedings in Nigeria, the creditor bankruptcy proceedings and the debtor bankruptcy proceedings. Both proceedings culminate in a receiving order against the assets of the debtor to be used to liquidate the debts owed to its creditors. While the creditor bankruptcy proceedings provide an avenue for the recovery of debts as set out in the Bankruptcy Act, the debtor bankruptcy proceedings serve to provide a protective measure for the debtor against its creditors. The creditor is required to have first obtained a judgment against the debtor in a separate suit before instituting the creditor bankruptcy proceedings. Thus the creditor bankruptcy proceedings can only be used to enforce payment of debts.

Insolvency proceedings may lead to the appointment of a receiver or receiver manager for the winding up of a company. Proceedings leading to the winding up of a company may be through:

- voluntary winding up by members of a company following the passing of a special resolution for that purpose in a general meeting;
- winding up by the court; and
- winding up under the supervision of the court.

Investment vehicles

15 Investment entities

What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

Recognised investment entities in Nigeria include Nigerian companies, real estate investment companies and real estate investment trusts (REITs).

Entities seeking to invest in real estate will be required to pay applicable tax. Stamp duty is payable on any written instrument evidencing transfer of the property purchased; capital gains tax is payable on any gain made on the disposal of the investment property; land use charge or tenement rate is payable annually on the property; and withholding tax may be applicable to rents paid by the tenants in respect of an investment property (whether they are owned by Nigerian or foreign entities).

In Nigeria, the REIT structure minimises the REIT's exposure when compared with Nigerian companies. Unlike Nigerian companies, REITs are allowed to distribute up to 90 per cent of their taxable income to investors.

16 Foreign investors

What forms of entity do foreign investors customarily use in your jurisdiction?

Offshore investors customarily make investments using entities incorporated in Nigeria. Generally, Nigerian law allows 100 per cent foreign participation in companies incorporated in Nigeria. Companies incorporated in Nigeria (whether or not the shareholders are Nigerians) are regarded as Nigerian entities under the law.

17 Organisational formalities

What are the organisational formalities for creating the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

Companies incorporated in Nigeria must comply with the provisions of CAMA and must be registered at the CAC. In order to incorporate a company, the name of the proposed company is required to be approved and reserved at the CAC. Further to the name reservation, the memorandum and articles of association as well as other incorporation documents containing details of the shareholders, directors and company secretary are prepared, stamped and filed at the CAC. A certificate of incorporation is issued by the CAC once the incorporation process is completed.

See question 15 for the tax consequences for a foreign investor.

The type of entity most advantageous to a foreign investor is dependent on the investor's business objective and the circumstances of the transaction.

Acquisitions and leases

18 Ownership and occupancy

Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

Generally, land ownership in Nigeria is a leasehold. Under the Land Use Act 1978 (LUA), all lands in every state of the Federation are vested in the state governors who should hold such land in trust for Nigerians. The state governor grants a right of occupancy evidenced by a certificate of occupancy (C of O) for a period of up to 99 years (ie, leasehold interest) in land or property in his or her state. The terms of the leasehold are contained in the C of O granted by the governor.

Before the enactment of the LUA, land and properties were generally held as freehold by families and communities and it was possible to transfer freehold interest. Persons who immediately before the commencement of the LUA had vested rights in developed land continued to have right over such land as if they have a statutory right of occupancy issued under the LUA.

19 Pre-contract

Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

Non-binding agreements such as heads of terms, letters of offer and memoranda of understanding typically precede the execution of a binding contract of sale. The courts in Nigeria will not enforce such non-binding agreements as they merely indicate that subsequent binding agreements will be entered into.

While the purchaser or lessee in a property transaction would require the property to be taken off the market during negotiation, the decision to take the property off the market is based on the negotiation of the parties. In some cases, the vendor or lessor may agree a consideration for taking the property out of the market. Such consideration is built into the purchase price or lease.

20 Contract of sale

What are typical provisions in a contract of sale?

A contract of sale would usually contain details of the contracting parties, a recital detailing the historical background of the property, the

total consideration or purchase price of the property, the initial deposit to be made by the purchaser and payment plan for the balance in instalments, covenants and obligations of the parties, warranties and representations, indemnities, dispute resolution clauses and governing law.

21 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

Responsibility for future environmental clean-up of the property rests with the owner of the property.

It is not common to have clauses regarding long-term environmental liability and indemnity that survive the term of a contract of sale.

If the term of a lease or contract of sale is breached, a variety of remedies including damages and injunctive relief are available to the affected party.

22 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

A vendor of a property may make representations as to the existence and nature of leases in respect of the property, rent payable, unexpired term of the leases and default. Depending on whether the purchaser intends to inherit the leases, the vendor may covenant that the leases will remain subsisting at closing or that vacant possession of the property will be delivered to the purchaser at closing. Also, the vendor would typically covenant that the property is free from any form of encumbrance or adverse claimant; to vest the property in the purchaser upon payment of the total purchase price; and execute the relevant title document in favour of the purchaser.

It is not customary to require the tenants to issue estoppel certificates as a condition to the obligation of the buyer to close under a contract of sale.

23 Leases and real estate security instruments

Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

Leases are usually subordinate to security instruments. Security interests on land are created over and above the interests and rights of the landowner including the landowner's rights of possession, right to collect rent or leases over the property.

Leases typically will not rank in priority to security instrument. However, existing contractual rights of the lessee based the lease would be protected in the event of the enforcement of security interest over a property.

It is not a typical market practice in Nigeria for lenders to require subordination and non-disturbance agreements with the tenants.

Head leases are treated differently from commercial leases. The ultimate title to land vest in the governor of the state, hence the governor is usually the head lessor. Subsequent leases or security interests over land are subject to both the governor's consent and the terms statutory right of occupancy granted by the governor to the landowner.

24 Delivery of security deposits

What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

Security deposits in Nigeria are generally known as caution fees or asset replacement deposits. Where the purchaser intends to inherit the tenants, the contract of sale would contain provisions requiring the seller to transfer all or the unutilised caution fees or asset replacement deposit paid by the existing tenants.

It is common in leases for the tenant to be required to pay a caution fee as security against any damage to the property. The security deposit or the unutilised balance is refunded to the tenant by the landlord at the expiration of the lease or tenancy.

It is also customary for lease agreements to contain rent review clauses to cushion the effect of inflation and keep the monetary value realisable from the demised property. There are no restrictions on rent reviews with respect to commercial and industrial premises as this is subject to the agreement of the parties. However, there are rent control laws in different states to curb arbitrary rent increases on residential premises.

25 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain a zoning report or legal opinion regarding legal use and occupancy?

The purchaser's solicitors will usually carry out title searches on the property at the relevant lands registry prior to the purchase of the property. Title searches aim to verify the title status of the property; reveal the existence or otherwise of any encumbrance; confirm the zoning regime; and verify that the property is free from government acquisition.

Where acquirers find out, following a title search, that the title to the property is bad and the defect cannot be amended or would be very difficult to amend, the customary approach is to back out of the transaction. Where the defect can be rectified, the interest acquirer may still proceed with the transaction but request a reduction in the purchase price be agreed by the parties.

26 Structural and environmental reviews

Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

Depending on the state of the property, a purchaser may, in addition to carrying out physical inspection and a valuation, commission civil or structural engineers to carry out structural integrity test on the property.

Where applicable, the purchaser may ask the seller questions relating to the existence or otherwise of an environmental impact assessment (EIA) certificate. Where the EIA is not applicable, the purchaser would be required to carry out environmental investigations.

A zoning report and legal opinion are not provided in all real estate transactions.

27 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

Lawyers usually review leases. The business side may check the execution version of the lease agreement to confirm that the agreed commercial terms have been reflected and, in some cases, also be involved in the review.

The lease issues indicated would depend on whose interest the solicitor represents. The issues to be considered by the lessor/landlord's solicitors would differ from that of the lessee/tenant's solicitors. Key issues for negotiation include payment or otherwise of service

charges, the vendor's title, vendor's or tenant's guarantee, use of common areas, lease payment review provisions, length of lease, termination provisions, assignment and sub-lease provisions, covenants, repairs and maintenance provisions, dispute resolution mechanisms, etc, among others.

28 Other agreements

What other agreements does a lawyer customarily review?

The other agreements to be reviewed would depend largely on the due diligence conducted by the lawyer. It is dependent on the searches, type of property, length of lease, agreed commercial terms, vendor's title, etc.

Some agreements that may be reviewed include property management agreement, head lease (where applicable), deed of conveyance or assignment, deed of lease or sub-lease and estate rules and regulations (where the property is situated in a serviced estate).

29 Closing preparations

How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

Lawyers customarily prepare for the closing of real estate transactions by having physical meetings or tele-conferences. Such meetings seek to ensure that all conditions precedent for completion are in place. The lawyers would customarily confirm, among other things, that:

- the purchaser is ready to make payment of the balance of the purchase price (in respect of a sale) or rent (with respect to a lease);
- the formal conveyance/lease agreement by the parties are in agreed form and ready for execution;
- other relevant documents required for the registration of the purchaser's interest at the relevant lands registry are ready for execution;
- vendor/landlord is ready to deliver to deliver possession of the property to the purchaser/tenant (depending on the agreed terms); and
- the original title deeds and other documents (receipts, building plans etc) are ready to be handed over to the purchaser in the event of a sale.

The completion stage of the conveyance signifies the conclusion of all processes that vest the legal title on the purchaser and/or possession on the tenant. For real estate financing, lawyers to the lender and borrower (ie, the purchaser or investor) ensure that conditions precedent for drawdown are in agreed form and issue their respective legal opinion. Lender's lawyers will issue a letter confirming that the borrower has satisfied the conditions precedent.

30 Closing formalities

Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

Closing is typically done based on the preference of the parties. The parties may decide to close the transaction by a closing or signing ceremony or formal physical meeting between the parties and their lawyers. In some cases, a party duly executes its portion of the transaction documents and sends the same to the other party for countersignature.

For leases, there are no formal closing meetings and lawyers merely ensure that the necessary documents are signed and exchanged or transferred sometimes by post, delivery company or pick-up. In the event of immediate possession, the lawyers would also arrange and agree to a time and location for the tenant to pick up the keys to the property.

31 Contract breach

What are the remedies for breach of a contract to sell or finance real estate?

The remedies for a breach of contract to sell or finance would typically be included in the contract of sale. Such remedies may include specific performance mandating the performance of the contract (where the seller is able and unwilling to perform), refund of initial payment deposit plus interest at the prevailing market rate, etc. Such terms are usually included in the non-performance clause of the contract of sale or pre-sale agreement.

In the event of a breach of the contract of sale, the purchaser is entitled to terminate the contract and recover any payments or deposits made to the seller. Depending on how the contract of sale is drafted, the purchaser may also be entitled to recover interests on the moneys paid at the prevailing market rate.

There are other common law and equitable remedies that apply such as damages, specific performance, etc.

32 Breach of lease terms

What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply?

The remedies available to both tenant and landlord would depend on whether the breach was material or non-material. A non-material breach is one that pertains to a minor or ancillary detail of the contract of sale, while a material breach would be considered as a major defect going to the foundation of the agreement, for example, tenant's failure to pay rent.

The remedies therefore differ in proportion to the type of breach. For example, a landlord's remedies for breach of the covenant on use may include an action for:

- an injunction to prevent a contrary use;
- damages to compensate for misuse of the premises or breach of the covenant; or
- forfeiture and re-entry if there is a provision for it in the lease agreement.

On the other hand, the remedies for non-payment of rent may include an action for:

- recovery of the premises;
- payment of arrears of rent; and
- payment of mesne profit against a tenant at sufferance.

An action in distress, which is the seizure of the tenant's goods to satisfy the rent without going to court, may also be instituted.

Tenant's remedies may include rent abatement for non-material breaches such as failure to repair and repudiation of lease for material breaches such as breach of covenant of quiet enjoyment.

Nigerian law prohibits self-help measures in the eviction of tenants. The landlord is required to serve two notices on the tenant prior to the eviction of the tenant, namely notice to quit and notice to recover possession. The tenor of the notice to quit depends on the term of lease and cycle of payment of rent. Where the tenant refuses to give up possession on expiry of the notice to quit, the landlord will serve a notice of owner's intention to recover possession. Where the tenant refuses or fails to deliver possession to the landlord after seven days of receipt of the notice to recover the premises, the landlord may proceed to court to obtain an order for recovery of the premises. Once granted, the order of eviction will thereafter be enforced by officers of the court.

Financing

33 Secured lending

Discuss the types of real estate security instruments available to lenders in your jurisdiction.

The most common form of security instrument relating to real estate in Nigeria is a mortgage. Under a mortgage, the ownership of a real estate is transferred (by way of security for the loan) on the express or implied condition that it will be discharged when the loan is repaid. The mortgage may be a legal or equitable mortgage.

A legal mortgage is created when a deed of legal mortgage (an agreement under seal) is executed for transfer of the legal title to the secured asset from the borrower/mortgagor to the lender/mortgagee

subject to reconveyance or release to the borrower/mortgagor upon payment of the secured debt.

An equitable mortgage only transfers a beneficial interest in the asset to the lender/mortgagee with legal title remaining with the borrower/mortgagor. An equitable mortgage arises where the formalities to create a legal mortgage have not been completed; the asset being mortgaged is only an equitable interest; or there is mere deposit of title deed.

34 Leasehold financing

Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

Financing is usually not available for head leases.

35 Form of security

What is the method of creating and perfecting a security interest in real estate?

See question 33 with respect to methods of creating security and question 3 with respect to the perfection of security interest in real estate.

36 Valuation

Are third-party real estate appraisals required by lenders for their underwriting of loans? Must appraisers have specific qualifications?

Real estate appraisals are not required by law. However, it is customary for lenders to employ the services of a third-party real estate valuer to appraise the property to determine the market value and forced sale value of the property. The forced sale value is usually two-thirds of the market value. The lender may use this information to determine whether the loan would be granted, the size of the loan to be granted, or both. Most lenders would grant credit up to 70 per cent of the forced sale value.

Most valuation reports would contain certain assumptions as to the title of the property and its marketability, structural integrity, etc. While these assumptions are not headed as qualifications, they effectively qualify the valuation report.

37 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

A lender outside Nigeria can provide a loan facility to the borrower using collateral within Nigeria as security for same. The documents required to create the security are the same whether or not the lender is within or outside Nigeria and the consent of the governor or minister will be required where the security relates to land. In practice, the foreign lender engages a Nigerian lawyer to provide a legal opinion on the enforceability of the security, among other things.

In some states, the lands registry may allow lenders or other third parties with interest in a property to register a caution on the property in the lands registry. Such cautions are required to be discharged before the property or any part of it can be transferred.

38 Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

In Nigeria, interest rates are usually linked to the Central Bank of Nigeria's monetary policy rate or the Nigerian interbank rate (NIBOR) published from time to time by the Central Bank of Nigeria and FMDQ OTC Securities Exchange respectively.

In addition to the interest rate, there may be fees such as arrangement fees, commitment fees, monitoring fees, renewal fees, etc, depending on the terms agreed by the lender and borrower.

While there is no provision on the maximum interest rate chargeable by a lender, parties always seek to have competitive pricing for loan facilities.

39 Loan default and enforcement

How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

Depending on the provisions of the loan agreement and security documentation there are a number of ways the lender's remedies can be enforced. Some of these are:

- right to foreclose: this transfers the ownership rights over the security to the lender;
- enforcement of covenant to repay: this covenant is typically stated in the loan documentation; however, where it is omitted it remains implied and through the courts the borrower may be ordered to pay the loan or debt with interest and costs accumulated during the period of default;
- appointment of a receiver: a receiver may be appointed by the court to receive rents and profits over the security until the case is determined by the court or the debt is satisfied;
- right to take possession: this allows the lender take possession of the security and carry on business on it as if it were the owner, thereby allowing the lender to realise its debt; and
- right of sale: where the legal mortgage is created by a deed, the lender may be authorised by the court to sell the security in order to realise its debts.

A lender can institute a foreclosure proceeding where the date of redemption has passed with the principal and/or interest remaining unpaid after a demand and a reasonable time has to lapse without compliance.

There are no restrictions on the type of legal action that can be instituted by lenders. Where one action does not satisfy the debt owed to the lender, the lender can take the benefit of another remedy. However, the lender is barred from taking the benefit of any other legal action once the lender commences foreclosure proceedings against the mortgagor.

40 Loan deficiency claims

Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

A lender's entitlement to have recourse to the borrower or guarantor typically depends on the provisions of the facility documents. While most real estate finance facilities entitle the lender to recover any shortfall (after the sale of the property) from the borrower and any guarantor, some facilities are limited recourse or non-recourse facilities.

The limitations on the amount or method of calculation of the deficiency will also be based on the facility and security documents.

41 Protection of collateral

What actions can a lender take to protect its collateral until it has possession of the property?

Registration of a registrable collateral is one of the key ways in which a lender would protect the collateral. Registration is done in the following ways:

- over land: registration at the relevant lands registry;
- over company assets: registration at the CAC; and

- over chattels and personal moveable property: registration at the collateral registry of the Central Bank of Nigeria.

The security document usually empowers the lender to appoint a receiver to realise the security in the event of default by the borrower.

For unregistrable collateral, the lender would typically take possession of the title documents and/or use employ the use of negative clauses/prohibitive covenants in the loan documents.

42 Recourse

May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

The loan agreement or document may stipulate and determine whether the loan is granted on a recourse, limited recourse or non-recourse basis. In addition to a legal mortgage, a lender may also require the borrower to provide an all-assets debenture (which is a fixed and floating charge of all its assets and undertakings). The loan and security agreements executed by the parties will also affect the enforcement procedure that will be adopted by the lender and, by extension, the extent of the liability of the guarantor.

Recourse to the guarantor is determined by the provision of the facility agreement or guarantee/indemnity agreement (where there is a stand-alone agreement). Personal recourse to guarantors may extend to levying an execution against the assets of guarantor.

43 Cash management and reserves

Is it typical to require a cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

Cash management systems and reserves are not typically required in real estate transactions.

44 Credit enhancements

What other types of credit enhancements are common? What about forms of guarantee?

Guarantees can be utilised as credit enhancements. Guarantees in this regard are issued by an entity other than the originator or seller or its subsidiary or affiliate, its parent company or the parent company's subsidiary or affiliate, or the trustee.

45 Loan covenants

What covenants are commonly required by the lender in loan documents?

Financial covenants and negative pledge or prohibitive covenants are the most commonly used covenants required by the lender in loan documents. Other covenants are undertakings by the borrower to repair, to maintain and/or to insure the property, covenant on punctual payment, compliance with applicable law and contracts, etc.

46 Financial covenants

What are typical financial covenants required by lenders?

This will depend on the type of loan or lending agreement in which the covenant appears. Typical covenants are restrictions on debt levels, minimum working capital requirements, negative pledge, use of proceeds, upstamping, interest coverage ratio, borrowers change of control, material adverse conditions, material adverse effect, termination process, further assurances, etc.

47 Secured moveable (personal) property

What are the requirements for creation and perfection of a security interest in moveable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

Security interests in moveable (personal) property are registered in the collateral registry administered by the Central Bank of Nigeria. All finance leases (whether registrable or unregistrable) entered into after 2014 must be registered at the collateral registry.

48 Single purpose entity (SPE)

Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

There is no requirement by lenders that a borrower should be an SPE. Many borrowers choose to use SPEs for acquisition financing where the debt, equity and financing techniques are used to achieve the acquisition of real estate.

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General

1 Legal system

How would you explain your jurisdiction's legal system to an investor?

Portugal is a civil law jurisdiction ruled by the Constitution of 1976, which has been amended seven times. Portugal has been a full member of the EU since 1986 and is part of the eurozone.

The Portuguese state is a republic under a semi-presidential regime, where the president is directly elected by the people for mandates of five years. He or she appoints the prime minister , normally the leader of the party winning the elections for parliament, and he or she has the power in exceptional circumstances to dismiss the government before the end of each mandate of four years, basically when there is no majority or coalition supporting the government.

Parliament has exclusive competence to pass legislation in the form of laws on important issues, such as the yearly budget law, taxes or revision of the Constitution.

Portugal is a civil law country and has a codified law, covering not only the several branches of legislation (civil, penal , tax, commercial corporate, securities and markets, public and administrative law) but also the codes of procedure that are in force, basically regulating court actions.

Courts do not rule on equity and oral contracts are not valid in relation to property transactions.

2 Land records

Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

All Portuguese land, both public and private, and the buildings thereon are registered online at property registration departments, which are part of government public administration. This includes land located in Madeira and in the Azores.

Ownership identification is registered and also all other property rights such as property transfers, mortgages, charges, liens and encumbrances of any kind and all kinds of property rights.

All acts of compulsorily registration, such as a mortgage, are invalid if not registered, and they are not opposable by other parties.

The areas of land and buildings are described in detail.

A parallel record is kept by the tax authority for tax purposes.

3 Registration and recording

What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

Registration is based on the acts or contracts engaged by the owners, or interested third parties, and these must be executed by the parties before a notary or a lawyer with notarial powers of authentication and certification. Certified copies are then recorded.

The notarial officer must also obtain and refer, in the act being executed, to the certified copies of the registration of each property, as the subject of any type of transaction.

The same applies to receipts for payment of the property transfer, tax and stamp duties, always paid as a percentage of the price by the buyer.

The legal regime of property registration gives assurance to a buyer and to an interested third party about what the subject of the transaction is, and a guarantee of the entitlement to property rights.

4 Foreign owners and tenants

What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

There are no limitations on foreigners acquiring or leasing property in Portugal, but they have to register with the local tax authority, and taxes are levied on property income.

The main point to be taken into consideration is to have a full property search by a lawyer. Real estate agents, who are normally paid by the seller, should not be put in charge of the search or of producing an independent legal opinion.

When rural land is to be purchased for development, then the search becomes even more crucial and all legislation and regulations applying to the area or zoning of a particular property must be examined in detail.

Real estate agents need a licence to operate in Portugal.

5 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

There are no exchange control rules under EU rulings on the free flow of capital.

Banks, notaries and lawyers must check on the origin of funds and their legal background.

Buyers are subject to a 'know your customer' procedure to ensure compliance with regulations, carried out by banks, lawyers and notaries.

6 Legal liability

What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

The owner of a property has legal civil liability in relation to third party damage caused by or linked to the property, environmental liability for not complying with the law, and personal liability for his or her acts.

The same applies to further owners, tenants , lenders or any third party entitled to any sort of property right on any property.

Joint liability may also occur when the causes of damage and loss are considered.

7 Protection against liability

How can owners protect themselves from liability and what types of insurance can they obtain?

Any type of insurance can be obtained both in Portugal and abroad, particularly in EU countries under the rules relating to transborder financial services.

Insurance does not follow the regime of property rights, which follows the rule of law of the country where the property is located (lex rei situs).

8 Choice of law

How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

According to the lex rei situs principle of our conflict of laws rules, all rights concerning properties located in Portugal have to abide by Portuguese law both in substance and form.

For example, one cannot acquire property rights through an informal contract with no notarial intervention; oral contracts on properties are null and void; property rights can only be acquired by legal persons (individuals or corporate entities); at present a trust cannot acquire directly property in Portugal.

One should not involve two jurisdictions in a transaction, save in the case of a swap of properties, one located in Portugal and the other in another country, but in this case the acts executed according to the rules of another jurisdiction should follow Portuguese law, both in the substance and in the formalities, in order to produce effects in Portugal.

9 Jurisdiction

Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

Parties may choose the jurisdiction for a dispute, including arbitration; however, the court should be prepared to apply Portuguese property law in relation to property rights, failing which enforcement in Portugal could be questioned.

Portuguese procedural law applies the rule of legitimacy, which is very broad, and any party having an interest in the litigation may intervene either spontaneously or by being called.

The parties in a litigation case must always be the subjects of the act or contract leading to a dispute. A claim may be introduced against non-identified parties for recognition of a right.

Out-of-jurisdiction service varies according to any conventions that Portugal is party to, and in their absence in relation to particular countries the rules of the Code of Civil Procedure contemplating service in a foreign jurisdiction apply.

A party does not need to be qualified to do business in Portugal to enforce remedies in the country, unless the business activity requires a specific licence, such as for real estate agents.

10 Commercial versus residential property

How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

The same rules apply to commercial and residential property in relation to acquisition or disposal of property rights.

With rented property the regime is the same and the property owner and the tenant have complete freedom to define the terms and conditions of rental agreements, this regime being very sensitive to market conditions.

Financing is available for purchase, refurbishing and development of properties in identical terms for Portuguese and foreigner nationals.

Enforcement of rights is identical for all types of property.

11 Planning and land use

How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

Planning and land use are both regulated in law and regulations. There are plans at the level of each municipality that are regularly revised (PDM) and also urbanisation plans with a broader scope (PU), with which the PDMs must conform.

The government's general plan for territorial development should also be taken into consideration.

These plans should always be thoroughly checked by any investor wishing to invest in the development of rural land.

Particular due diligence must be made on land by the coast and by rivers and lakes, as the shores are subject to maritime public domain rules, with limitations on construction and development.

12 Government appropriation of real estate

Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

The right to private property is expressly recognised in the Constitution, and requisition and appropriation for public use is only possible on payment of just compensation (article 62 of the Portuguese Constitution).

Owners may always dispute the requisition and appropriation, the amount of compensation, or both in the administrative courts.

A proposed appropriation is always notified to the owner to enable acceptance or challenge. A court claim will in generally take place only after the final decision.

13 Forfeiture

Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

Forfeiture without compensation occurs when properties are purchased with funds deriving from criminal activities, and when the court decides, in a sentence not subject to appeal, that the assets resulting from the criminal activity are forfeited.

14 Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency system in your jurisdiction.

A debtor who is no longer able to pay his or her debts, even when being incapable of doing so through the sale of assets, will be considered technically insolvent. Any creditor may resort to court to claim a declaration of insolvency.

The debtor may apply for protection and for a negotiation procedure (PER), which will last for a roughly one year, and if no agreement is reached then the procedure follows as with insolvency.

An administrator of the bankruptcy is appointed by the court and he or she has full powers to manage the assets. Credit privileges given, for instance, by mortgages or pledges may be recovered in full, unless annulled by the judge in specific cases.

Investment vehicles

15 Investment entities

What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

Apart from individuals, corporate structures in general may acquire property rights in general and are subject to the same rules.

For property development, rental investment and personal use, investors may choose to make the investment through an SPV or a more elaborate tailor-made corporate structure, taking into consideration tax planning and activities related to the assets.

As trusts cannot directly own property it is usual to make purchases through SPVs based in jurisdictions with a convenient law on trusts, with the shares then transferred to the trusts as settlement.

There is a list of more favourable tax jurisdictions that are blacklisted and penalised with much higher property taxation (property transfer tax and yearly property tax), which has been approved by Ministerial Decree No. 150/2004 of 13 February and may be consulted online at www.bportugal.pt.

In relation to liability, in limited liability companies the shareholders are only responsible for their capital subscription, unless personal liability is assumed.

16 Foreign investors

What forms of entity do foreign investors customarily use in your jurisdiction?

There are no limitations on the use by foreign investors of any Portuguese or foreign entities, the choice being made taking tax planning into consideration.

17 Organisational formalities

What are the organisational formalities for creating the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

A Portuguese company may be easily incorporated and registered, and it can take a week or a month depending on each particular case. A law firm with lawyers registered with notary powers simplifies the procedure of incorporation and registration.

One should always choose a simplified limited liability company or a public limited company.

Companies incorporated in other jurisdictions are subject to local laws and rulings.

Taxation issues deriving from income of the property are always dependent on the owner's tax planning.

Transfers of properties are subject to a property transfer tax of 6 per cent in most cases on the sales price (IMT) and a yearly property tax of around 0.3 to 0.6 per cent in most cases (IMI) on the tax value of the properties, which are regularly evaluated.

Acquisitions and leases

18 Ownership and occupancy

Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

Properties may be owned in full by one person or entity, or more than one owner in co-ownership, or in cases where ownership is divided between the owner and a person entitled to a usufruct, for life or for a limited period of time.

Other property rights may not be connected to full ownership, such as rights of use, rights of way, pre-emption rights, rights of surface, air rights or leasing agreements, all these either for life or limited in time.

To produce full effects and in order to be binding on future owners these rights must be registered with the Property Registration Department, and they are created by formal certified documents by a person with notarial powers.

19 Pre-contract

Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

In most sales there is a promissory contract with a down payment of a percentage of the price, to allow for due diligence, financing and other necessary paperwork before completion.

The down payment is normally paid to the seller, but it can be kept in escrow or be subject to a return guarantee.

If a written promissory contract is not signed the seller and the buyer are not bound to complete.

If the buyer defaults in the promissory contract, he or she forfeits the down payment; if the seller defaults he or she must return double the down payment. If there is a clause foreseeing specific performance, the non-defaulting party may go to court and seek a decision of the judge to transfer the property.

For a promissory contract to be valid it must always be in writing and it is advisable to have the signatures of the parties certified.

A term sheet or a letter of intent are not normally used, as liability would always need to be linked to acting in bad faith, unless a penalty clause is pre-established.

If during a negotiation a property is not taken off the market the interested buyer should be formally told to avoid any future claims based on pre-contractual liability.

20 Contract of sale

What are typical provisions in a contract of sale?

The legal requirements for the formalisation of a contract of sale are the following:

- identification of the owners and the buyers and respective spouses and regimes of property in the marriage;
- identification and brief description of the property based on the Land Registry and attachment of a certificate;
- reference and description of mortgages and charges, and any other registered limitations on full property rights;
- price, form of payment and express declaration of the seller of what he or she has received; and
- statement that property tax and stamp tax have been paid, and attachment of the receipts of payment.

The deed is then registered at the Land Registry.

Warranties and representations are not legally necessary for the deed to be valid, but it is advisable to include them, especially with new properties for the construction guarantees.

If there is a loan involved the loan agreement is made at the same time, and a mortgage is given. Banks always ask for a provisional registration of the mortgage prior to the sale to avoid other last-minute registrations that would supersede the registration of the mortgage deed.

Taxes are normally paid pro-rata in relation to the month of completion, unless agreed otherwise, the tax year being the same as the calendar year.

21 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

These should be contemplated in the warranties and representations in the deed.

A new owner will be liable for any clean-up not executed by the former owner, or never ordered by the authorities.

22 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

These are left to the parties to the transaction, and there is broad contract freedom to include in the agreements any arrangements agreed by the parties that do not offend specific laws or public order rules.

Lease agreements and rental agreements must be disclosed during negotiations and variation clauses in relation to the object of the sale (the property and attached property rights) are normally included, with eventual alteration of the price.

These clauses may also include the payment of brokerage fees, although normally these are paid by the buyers.

On sales of commercial property there is normally a guarantee of rent, which constitutes the basis of an agreed yield.

No formal estoppel certificates are used, but a certificate from the Property Registration Department may constitute a substitute as it will describe the mortgages, charges and liens on a property and in relation to leases or rentals the respective agreements may be part of the warranties and confirmed by the tenants.

23 Leases and real estate security instruments

Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

Generally, lease agreements are not secured by nor subordinated to any particular security instrument. Tenants usually face other types of warranties, namely upfront payment of rents, security deposits or third-party personal guarantees.

It is worth noting that head leases are not available under Portuguese law. On the other hand, ground leases are not common in Portugal.

In relation to commercial leases there are no relevant differences as to the security instruments applicable.

24 Delivery of security deposits

What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

As a general rule, the delivery of tenant warranties to a buyer is attained through the incorporation of specific contractual provisions in the agreement, aimed at allowing the fulfilment of the conditions required for the acquisition of the real estate.

Monthly rents may be subject to annual increases as a result of the application of a coefficient published annually by the Portuguese government. Nonetheless, the parties may agree as regards rent reviews.

25 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain a zoning report or legal opinion regarding legal use and occupancy?

Legal due diligence is normally conducted before the execution of a purchase and sale agreement or the completion of the relevant promissory contract.

The most important title search comprises the relevant land registry certificate issued by the Land Registry. This certificate evidences the registered owner of the property and acknowledges all existing encumbrances of the real estate that are registered (eg, mortgages, servitudes, surface rights, etc). The land registry certificate may be requested, in digital form or hard copy, online or in person at any Land Registry.

It is also necessary to confirm with the relevant tax office that the seller is registered as the owner of the property and that all taxes due on the property have been fully paid.

In addition, if the purchaser's intention is to carry out new construction work on the property, it must be checked with the local authorities whether it is statutorily possible to build on the plot of land. Enquiries should also be made about the applicable construction requirements. A technical habitation certificate is also required, a compulsory document relating to properties intended for residential purposes and completed after March 2004, along with the energy certificate, referring to the performance and energy use of a building.

Legal due diligence of the above-mentioned documentation provides clear and objective information regarding the legal and material status of the property, allowing the purchaser to protect itself in real estate transactions, namely through the incorporation of specific representation and warranties in the contractual provisions.

Under Portuguese law, registration is mandatory of any acts or facts that create, recognise, acquire or modify any real estate rights. This said, the priority principle is one of the general principles governing the Portuguese registration system, evidencing that the right registered earlier in time shall prevail over all rights registered subsequently. As an exception, mortgages registered on the same date compete with each other, in the proportion of the credits secured. Moreover, privileges and liens are also worth mentioning. Privileges are charges legally imposed in favour of privileged creditors, which are not subject to registration and nevertheless prevail over mortgages. Additionally, liens also prevail over mortgages.

26 Structural and environmental reviews

Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

Engineering and environmental assessments are customary in relation to commercial and industrial real estate transactions, and their completion depends on the nature and use of the property. However, it is not common practice to incorporate particular contractual provisions as regards technical reviewers, namely, representations and warranty clauses.

Environmental insurance is available and there is a legal obligation on operators to provide a financial guarantee as to environmental responsibility. Financial guarantees may be obtained by means of insurance policies, bank guarantees and participation in environmental funds.

It is quite common to obtain a zoning report and legal opinions before executing a real estate transaction.

27 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

Lawyers may be called to draft or review and negotiate lease agreements.

In addition to the general terms and conditions typical of any lease agreement, there are several key aspects that must be stressed, namely, the legal capacity of the parties, the description of the property and if it has any liens and encumbrances, along with the necessary licences and insurances required for the execution of the real estate transaction and project.

28 Other agreements

What other agreements does a lawyer customarily review?

Lawyers may also review other agreements such as construction agreements, management agreements, brokerage agreements, financing agreements, insurance policies and condominium regulations, among others.

29 Closing preparations

How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

Except obligations relating to the protection of pre-emption rights, and energy and air quality reviews to be complied with before a purchase and sales agreement, closing preparations do not usually involve any compulsory procedure.

In Portugal, the creation and acquisition of real estate rights usually starts with the execution of a promissory contract, subsequently followed by the conclusion of the definitive agreement of transfer of ownership of the property (closing), by means of a public deed or an authenticated private document, and its registration before the Land Registry.

The parties are free to choose the time elapsing between the promissory purchase and sale contract and the definitive agreement (closing), which will vary depending on the need to prepare and fulfil the conditions that must be complied with before the acquisition of the property.

30 Closing formalities

Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

Except for mortgages, which are usually executed by means of a notarial deed, generally the closing of the transfer of ownership, leasing and financing is done in person, with all parties present or duly represented. Closing may be conducted at the office of one of the parties or the lender, with or without the presence of a notary.

31 Contract breach

What are the remedies for breach of a contract to sell or finance real estate?

In the event of a breach of contract, the non-defaulting party may claim for any damages that may arise. Real estate property is usually enforced in court.

32 Breach of lease terms

What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply?

Any breach of the terms of the lease allows the non-defaulting party to claim compensation for any damage arising from the breach. In such cases, general contractual rules and special compulsory regulations are applicable.

Unless otherwise agreed, the non-defaulting party has recourse to the following remedies:

- breach attributable to the purchaser: the promissory seller may keep the amount received as a deposit;
- breach attributable to the seller: the promissory purchaser may claim twice the amount of the deposit.

As an alternative to the above-mentioned remedies, the non-breaching party may, in certain circumstances, apply in court for the compulsory execution of the promissory purchase and sale agreement.

Additionally, any party may terminate the lease agreement in the case of default of the counterparty. The tenant can only be evicted following the valid termination of the lease agreement, which must be judged and declared by a civil court of law, by means of a special enforcement procedure. Recent legislation has created the National Office for Leases with jurisdiction over Portuguese territory to manage special eviction procedures.

Financing

33 Secured lending

Discuss the types of real estate security instruments available to lenders in your jurisdiction.

Loan agreements secured by mortgages are the most typical real estate security instruments in Portugal. In effect, the mortgage secures the payment of a debt by the value of an immoveable property, granting to its holder, in the event of contractual breach, the right to be paid from the proceeds of sale of the property with priority in relation to any other creditors, provided other creditors do not benefit from special privileges or prior mortgages, such as would be the case of the tax authority in respect to property taxes. It is worth noting, however, that mortgages do not grant holders the right to possess or acquire the object. The sale of the mortgaged property is normally made through a judicial auction and the debt is cancelled with the funds arising from it.

Further security instruments include:

- rent assignments, which secure the payment of a debt by the profit of immoveable or moveable assets subject to registration, and which are created by a public deed and subject to registration;
- pledges, which secure the payment of a debt by the value of a moveable asset or a right;
- privileges, which are always legally stated and not subject to registration, and which establish that certain creditors have the right to be paid with precedence because of the nature of their credit; and
- liens, where the debtor has a credit against the creditor and has the right to keep the property until a debt owed in connection with it has been paid.

34 Leasehold financing

Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

Financing ground leases is not common in Portugal.

35 Form of security

What is the method of creating and perfecting a security interest in real estate?

The creation and perfection of a security interest in real estate depends on its source and on the need for its registration at the Land Registry. Taking into account its source, a security may be created by an agreement entered into between the parties or a third party as guarantor. On the other hand, the security may be establish by statute, owing to the nature of the person or debt in question, or given by a court order.

With regard to securities subject to registration, mortgages are the most common ones when it comes to real estate transactions. Mortgages are created by means of a public deed or a private deed certified by a notary, a Land Registry officer or a lawyer, and their validity and enforceability depends upon its registration at the Land Registry. The priority principle has full applicability and the date of registration shall determine the rank of the mortgages in the order of payments. Inscriptions with the same date shall have the same rank and be concurrent at the proportion of the credit.

The mortgage deed must specify the cause of the mortgage, the credit, the accessories and maximum amount secured. The mortgage may include interests for three years and also a certain amount for recovery of expenses.

The mortgage must be enforced by means of a judicial process in the course of which the property is seized and subsequently sold and the creditor paid with the revenues of the sale.

36 Valuation

Are third-party real estate appraisals required by lenders for their underwriting of loans? Must appraisers have specific qualifications?

Institutional lenders usually require independent real estate appraisals, notably with regard to real estate transactions of significant value.

Appraisers must have professional skills and capacities, which must be attested by public certification and licence.

Update and trends

Of note in Portugal are:
- foreign investment; and
- new regulation of urban leases.

37 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

Foreign lenders do not have any additional constraints when compared with Portuguese lenders. In fact, the latter will also have to comply with legal formalities and proceedings relating to real estate security instruments. See questions 32 to 35.

38 Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

Portugal internal rates are referenced to EuriBOR rates.

The Portuguese Central Bank establishes interest rate limits, which vary according to the type of financing. Rates will be reduced should a loan exceed the reasonable limit established by the Central Bank.

Fees and lender costs are not considered as interest for the calculation of unreasonably high rates.

39 Loan default and enforcement

How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

All remedies are subject to a judicial procedure. Under certain circumstances, it is admissible to enforce all types of collateral in one single judicial proceeding.

The time frame for foreclosure may vary depending on the nature of the remedy and complexity of the claim.

There are no specific restrictions on the types of legal action that may be taken by lenders.

40 Loan deficiency claims

Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

Damage or deficiencies have to be compensated by the debtor's remaining wealth or existing income, or both, within certain limits imposed by law. There are no limitations on the amount or method of quantifying the deficiency.

41 Protection of collateral

What actions can a lender take to protect its collateral until it has possession of the property?

The lender may protect its collateral by incorporating contractual provisions in the relevant agreement that forbid the buyer to provide security to a third party, along with termination clauses in the event of breach of the loan agreement. Should there be a mortgage, in general, registration confers priority to the lender on claiming and being paid before the subsequent creditors. Notwithstanding, the lender and mortgagee are not entitled to take possession of the property in the event of default, but the property is seized when court execution proceedings start. See question 33.

42 Recourse

May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

Security documents do not allow recourse to all of the assets of the borrower, and recourse is typically limited to the specific collateral created to secure the credit.

Within an insolvency procedure, rights over secured assets will be ranked according to special legal criteria, but mortgages will grant the title-holder priority in payment over any other unsecured or common creditors.

If the collateral is not sufficient to cover the whole claim of the lender, the lender is treated as an unsecured creditor for the excess amount not covered within the bankruptcy or insolvency procedure.

43 Cash management and reserves

Is it typical to require a cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

Lenders usually require cash management systems in real estate transactions involving significant values, situations, namely real estate project finance transactions, funding of sale and leaseback transactions, and loans for construction projects.

Reserves can be required for a multitude of purposes, notably repairs or structural improvements, taxes, property licensing, public liabilities, etc.

44 Credit enhancements

What other types of credit enhancements are common? What about forms of guarantee?

In Portugal, it is quite common to have recourse to the following credit enhancements:
- bank security deposits;
- pledges over bank deposits, machinery, profits and interests, shares and bonds;
- secondary mortgages or additional mortgages;
- cash collateral accounts and security bonds;
- other types of bank guarantees; and
- personal guarantees.

Payment guarantees, along with completion guarantees, are also quite common. These forms of guarantee are generally enforceable by means of price reduction or retention, income or interest rate increase and retention or, in the event of default, through a judicial procedure.

45 Loan covenants

What covenants are commonly required by the lender in loan documents?

Covenants commonly required by lenders include:
- legal due diligence in order to assess the legal status of the property;
- periodic financial reporting from debtors; and
- ongoing appraisals of assets or business activity and legal disputes.

Should there be a mortgage, the lenders may include contractual provisions in the relevant agreement that forbid the buyer to provide further security to a third party, along with termination clauses in the event of breach of the loan agreement.

46 Financial covenants

What are typical financial covenants required by lenders?

In Portugal, financial covenants required by lenders are commonly based on loan-to-value ratios and debt-service coverage ratios.

47 Secured moveable (personal) property

What are the requirements for creation and perfection of a security interest in moveable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

The requirement as to the perfection of a security will vary depending on the type of security and type of asset.

48 Single purpose entity (SPE)

Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

There are no specific legal provisions and requirements to create and maintain special purpose entities.

Any person or entity may be appointed as a company director, and any director will be personally and unlimitedly responsible for tax and social security liabilities held by the company.

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General

1 Legal system

How would you explain your jurisdiction's legal system to an investor?

The Russian legal system is a civil law system, where laws and other statutes are the main source of law. Court decisions (precedents) are not viewed as a source of law; however, legal interpretations by supreme courts are binding upon lower courts. The Russian Federation's court system consists of the Supreme Court of the Russian Federation, commercial courts (by tradition referred to as state arbitrazh or arbitration courts) and courts of common jurisdiction.

Real estate and transactions are primarily regulated by civil (private) law. The main source for real estate civil transaction regulation is the Civil Code of the Russian Federation (CC) and all other laws containing any civil law provisions must conform to it. Other material codified Russian statutes that regulate real estate status and transactions include the Land, Forest, Water, Housing and Urban Development Codes. The transaction of real estate is also regulated by a range of federal laws.

On 1 January 2017, the new Federal Law No. 218-FZ of 13 July 2015, 'On state registration of real estate' (the Registration Law) will come into force, except for specific provisions coming into force later, introducing a single registration of titles to real estate and a cadastral recording system. The Registration Law establishes the procedure for legal acknowledgement and confirmation by the state of the emergence, change, transfer, limitation (encumbrance) or termination of titles to real estate and will replace the existing Federal Law on State Registration of Titles to, and Transactions with, Real Estate, which will become ineffective on 1 January 2020.

Russian procedural law empowers the courts to enforce security measures if sought by a party to litigation, in particular by issuing a property enforcement order or by prohibiting certain actions relevant to the subject matter of the dispute.

Russian courts try cases on the basis of the laws and other statutes of Russian regions and local municipalities, and international treaties to which the Russian Federation is a party. Russian courts admit oral witness statements in addition to other forms of evidence during trials. It should be noted, however, that the Russian civil law requires that real estate transactions be executed in writing and in cases provided for by a law to comply with state registration. If the written form of a real estate transaction is not complied with, as a general rule, the parties will not be in a position to refer to witness statements as the transaction evidence or its terms and conditions in the event of a dispute, in cases stipulated by a law or the parties' agreement the transaction will be void.

2 Land records

Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

After 1 January 2017, the existing double system of state registration of title to real estate and transactions therewith including leases and real estate security interests and a system of cadastral recording of real estate will be substituted for the unified single system of real estate registration. According to paragraph 2 article 131 of the CC, in special cases provided for by the law in addition to the system of state registration there is a system of special registration or recording in relation to certain real estate property. This system, for instance, exists to register state-owned (federal) real estate property.

The state registration of all rights stating someone's ownership of real estate or other proprietary rights as provided for by law, any other limitations and encumbrances in relation to such rights and real estate cadastral recording shall be carried out by the Federal Service for State Registration, Cadastre and Cartography (Rosreestr) and its territorial divisions. The Registration Law states that the registration of titles to real estate serves as a legal act of recognition and confirmation by the state of arising, change, transfer, limitation (encumbrance), termination of real estate interests. The Registration Law introduces the Unified State Register of Real Estate (URR), which will be maintained solely in electronic form and will contain information both about cadastral records of real estate and rights to real estate, and about data on the borders of different zones, special territories, water areas, etc, as well as data on land plans, register record files and cadastral maps.

The procedure, grounds and terms for state registration of title to, and cadastral recording of, real estate are specified in the Registration Law. As for real estate transactions to be registered under the CC as amended, non-compliance of such transactions with the state registration procedure does not entail legal consequences for such transactions in respect of third parties unless otherwise stipulated by law. In accordance with some statutory provisions, failure to register certain transactions that are subject to registration, for instance mortgage agreements executed up to 1 July 2014, does make such transactions void. Upon application by the person whose title to real estate was registered earlier than the registered one, objection to the registered title to real estate can be made. The real estate owner can submit an application for prohibition to register without the owner's personal presence.

The registered right to real estate can be challenged only in the courts. If the real estate's title is the subject matter of any trial, such information shall be entered in the URR. Interests in real estate are considered as having arisen, changed and terminated from the moment of registration. Like the current Registration Law, the new one recognises rights that arose prior to 31 January 1998 (the date the current Registration Law came into effect) are deemed legally valid, but it is necessary to obtain registration of any further transactions therewith.

3 Registration and recording

What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

The conveyance of title to real estate to the purchaser under a sale and purchase agreement, long-term lease and mortgage interests in real estate are subject to registration. The state registration of real estate leases is carried out through the registration of a lease agreement; a lease agreement for a period of more than one year shall be registered and regarded as duly executed from the date of such registration. Article 433 of the CC specifies that if the agreement is to be registered, it is deemed concluded for the third parties from the moment of its registration unless otherwise is stipulated by law. Therefore, as a general rule, such agreements shall be binding upon the parties, once duly signed.

The real estate sale and purchase agreement is not required to be registered. However, legal title to real estate is acquired by the purchaser

after registration of such title. The failure to register transfer of title to real estate to the purchaser is not a ground for declaring the sale and purchase agreement void. In the event of avoidance by one party from state registration of transfer of title to real estate the other party is entitled to bring an action in court for carrying out such registration.

Recent amendments to the Registration Law determine certain real estate transactions that are subject to notary certification:

- agreements on the sale of shares in real estate to non-co-owning third parties, with the exception for sales of shares in land plots and units in real estate unit investment funds;
- agreements on disposal of real estate on condition of trust or custody; and
- agreements on sale of a real estate owned by a minor or partially capable (specially disabled) person.

The new Registration Law sets forth shorter terms for state registration and cadastral recording:

- registration: seven business days from the date of the application receipt by Rosreestr;
- cadastral recording: five business days from the date of the application receipt by Rosreestr; and
- registration and cadastral recording simultaneously: 10 business days from the date of the application receipt by Rosreestr

Stamp duty is paid for the state registration of title to real estate and transactions therewith in the amount set out in the Tax Code. Since January 2015 the following stamp duty has applied to state registration of title, or limitations of title to real estate, or real estate sale agreements: for individuals, 2,000 roubles; for legal entities, 22,000 roubles. The stamp duty for state registration is payable by all parties to the agreement. Russian law does not provide for any option to minimise the amount of stamp duty.

4 Foreign owners and tenants

What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

Russian law grants foreign persons rights and obligations that are equal to those of Russian persons. Some exceptions are provided for in federal laws and international treaties.

As regards ownership of real estate, there are only few limitations in Russia:

- foreign nationals and legal entities are not entitled to own land located near borders;
- foreign nationals and legal entities in which more than 50 per cent of authorised capital is owned by foreign individuals and companies may possess agricultural land only on lease; and
- foreign nationals and legal entities are not permitted to own land in seaports.

As for the rest, foreign nationals and legal entities are free to acquire and own any other real estate in Russia. There are no requirements to comply with special procedures.

Foreign nationals and legal entities may hold real estate on lease without any restrictions. Some exceptions in relation to land are provided for in the Land Code.

For taxation purposes, foreign individuals and entities have to register with the Russian tax authorities at the location of their real estate. The tax duty on individuals' property concerns any real estate (apartment, house, building, etc) situated within urban areas. The amount of tax duty shall be determined on the basis of the cadastral price of real estate that is subject to taxation.

5 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

Settlements in a transaction between residents and non-residents, or between non-residents, where such settlements relate to the agreement, are not subject to any restrictions; however, they are subject to currency control regulations, primarily administered (in accordance with the Currency Regulation and Currency Control Law) via the certificate of currency transactions and the transaction passport executed by the resident party to the transaction.

Non-residents may transfer foreign currency and Russian national currency from their accounts with banks outside the Russian Federation to their accounts with authorised Russian banks, or repatriate foreign currency from their accounts with authorised Russian banks to their accounts with banks outside the Russian Federation, without any restrictions. But if the foreign investors are classified as residents under the Currency Regulation and Currency Control Law (ie, foreign citizens obtaining a residence visa), according to recent amendments to this Law, they have to submit a report on cash flow in respect of their foreign accounts (deposits) to the tax authorities.

The Foreign Investments Law entitles foreign investors to freely repatriate their income, profits and other foreign currency amounts legitimately received in relation to their earlier investments, in particular, distributions of earnings, dividends, interest, or transaction proceeds (after payment of taxes and levies imposed by Russian law).

6 Legal liability

What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

If the owner violates any rules applicable to the operation of certain property types, rules applicable to the conduct of certain business activity, as well as environmental, fire safety, sanitary or epidemiological or other requirements set out in regulations, technical standards and statutory procedures, it may be liable in accordance with the Code of Administrative Offences of the Russian Federation, which carries penalties in the form of fines or suspension of business activity.

The owner or tenant of real estate may face tort liability for damage caused to the property, life or health of third persons. Generally, the tort liability is imposed on the party who controls the real estate. Hence, if harm is caused by a tenant, the owner who has compensated the third person has the right to claim the amount of compensation paid from the tenant. In Russian civil law, the concept of claims arising from damage is based on the general tort principle, whereby everyone is prohibited from causing harm to the property or person of anyone else; harming another person is illegal, unless the person causing the harm was authorised to do so. General causes for tort liability are:

- harm caused;
- illegal conduct of the person who caused the harm;
- causal relationship between the first two elements; and
- guilt of the person who caused the harm.

The owners of real estate may also face criminal liability for crimes associated with serious damage caused to the environment, property, life or health of third parties.

In respect of real estate that is an object of cultural heritage or a land plot located in protective zones, the owner or tenant of such real estate may face liability for violation of rules applicable to the preservation, use and state protection of cultural heritage objects or special zone regime of land use in accordance with the Code of Administrative Offences of the Russian Federation, with a maximum penalty of 5 million roubles. On 12 May 2016 criminal liability for collecting citizens' funds in breach of the law on participation in shared construction was introduced into the Criminal Code of the Russian Federation; the maximum punishment for an offence involving up to 3 million roubles is imprisonment for two years, and for 5 million roubles it is imprisonment for five years.

Pursuant to articles 284, 285 CC as amended on 3 July 2016 a land plot intended for agricultural activity or for residential or other construction may be withdrawn from the owner upon a seizure decision by the state or municipal authority or a court decision if:

- the land plot is not used in accordance with its intended purpose within three years, unless a longer term is stipulated by law; or
- it is used in violation of legislation, particularly in nonconformity with its intended purpose or in a way leading to substantial fall in fertility of agricultural-purpose land or damage to the environment.

If the owner of a residential building (despite being warned) uses it other than for its intended purposes, systematically infringes its neighbours' rights and interests, or neglects his or her residence so that it falls into disrepair, the court may, acting upon a suit brought by the municipal authority, order the sale of such residential building via a public auction and reimburse the owner the sale proceeds. In accordance with the Federal Law on Environment Protection, legal entities and individuals responsible for damage to the environment are under an obligation to compensate such damage in full upon request of a competent government authority, which is based on approved tariffs and damage calculation methodologies or, where none exists, based on the actual expenses incurred to make good the damaged environment.

If the real estate is encumbered by a mortgage, such property shall remain in the possession of the borrower (mortgagor). The mortgagor is responsible for the risk of accidental loss or damage caused to collateral.

7 Protection against liability

How can owners protect themselves from liability and what types of insurance can they obtain?

Russian civil law provides for risk liability insurance for any obligations occurring by reason of harm caused to life, health or the property of others (including environmental risks). In this regard, foreign persons in Russia enjoy the right to insurance coverage on an equal footing with Russian individuals and legal entities.

Federal law may oblige persons to procure civil liability risk insurance (mandatory insurance). In relation to real estate, Russian law currently requires persons operating hazardous industrial facilities, for instance, owners of coal mines, to maintain mandatory liability insurance against potential harm caused by such operations. In construction, the civil liability risk insurance may function as a security to procure performance of the developer's obligation to hand over the residential premises under the shared construction participation agreement.

Where the insurance cover is an insufficient remedy for full compensation of the harm caused, the insured person must indemnify the aggrieved party for the difference between the actual amount of damages and the insurance cover. The insurer who pays insurance compensation acquires the right of a claim that the insuring party has against the person responsible for the damage.

8 Choice of law

How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

Pursuant to article 1213 of the CC, agreements in relation to any real estate located in Russia are governed by Russian law. This is an imperative provision that cannot be changed by an agreement. In relation to real estate located in any other country, the applicable law can be chosen by the parties.

If there is no choice of applicable law, the agreement shall be governed by the law of country to which it is most closely connected. There is a presumption that such law shall be the law of the country where the real estate is situated. It should be noted that Russian courts will apply mandatory rules of Russian legislation due to their special meaning or direct indication irrespective of applicable law under choice of law rules. As a general rule, in Russia contractual choice of law provisions are enforceable.

9 Jurisdiction

Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

There are no special courts competent to try real estate disputes in the Russian Federation. Such disputes are handled by either state arbitrazh (commercial litigation) courts, which are entitled to consider disputes in business relations, or by courts of common jurisdiction, which deal largely with individuals. The rules of procedure are based, respectively, on the Code of Arbitrazh Procedure and the Code of Civil Procedure.

Russian courts have exclusive jurisdiction over disputes in relation to real estate located in the Russian Federation. Meanwhile, the arbitral tribunals may also try real estate disputes as ruled by the Constitutional Court of the Russian Federation in a decision dated 26 May 2011 N-10p. The recent Federal Law No. 383-FZ of 29 December 2015, on Arbitration in the Russian Federation (in force on 1 September 2016), states that disputes arising out of civil law relations, including ones over real estate, which are subject to the competence of arbitrazh courts, except for certain categories of disputes specified by law, can be submitted to arbitral tribunals.

Foreign persons enjoy rights and obligations in Russian court procedures on an equal footing with Russian individuals and legal entities. At the same time, they must provide the court with evidence of their legal status and (in the case of arbitrazh courts) their right to operate in business activities.

The requirements for service of process to a party who remains abroad are regulated by Russian procedure legislation and international treaties to which Russia is a party. The out-of-jurisdiction service procedure is carried out upon the court's request addressed to the foreign competent institution for service of process. Any documents issued, prepared or certified by competent authorities of foreign countries will be accepted by Russian courts if legalised or apostilled, unless otherwise provided for by an international treaty to which Russia is a party. Any documents written in a foreign language must be filed with the court together with a properly certified Russian translation.

Statements of claim are to be filed as written documents. Requirements as to the content of the statement of claim and supporting documentation are set out in the Code of Civil Procedure and the Code of Arbitrazh Procedure respectively. The amendments to the Code of Arbitrazh Procedure that came into force on 1 June 2016 establish the mandatory pretrial settlement procedure before filing a lawsuit in the court for the majority commercial disputes arising out of civil relations. The dispute must be submitted to the court upon expiration of 30 calendar days from the date when the statement of claim or demand was sent. Non-compliance with pretrial procedure will entail return of the claim or its rejection without trial. The pretrial procedure is not required for certain categories of disputes stated by law and for disputes arising out of public (administrative) relationships unless otherwise stipulated by law. As for the special qualification for enforcement of legal remedies, there is no such requirement in relation to parties' representatives at court when hearings concern civil law matters. However, if a dispute concerning a real estate matter arises from an administrative (public) relationship, a party representative must be a bar member (an advocate) or at least have a law degree.

10 Commercial versus residential property

How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

According to current law residential premises are specific premises suitable for permanent residence of citizens (meeting the sanitary and technical standards and other requirements of Russian legislation). Residential premises include a residential building or its part, an apartment or its part, and a room. Title and other interests in residential premises are regulated by Chapter 18 of the CC and Chapter 5 of the Housing Code of the Russian Federation.

The main differences in the legal regime between residential and non-residential premises are the following:

- use of residential premises: the owner of residential premises is not allowed to use them other than for personal residence and residence of his or her family members or lease them to other persons under agreement;
- a different procedure of rearrangement or reconstruction;
- retaining the right of members of the owner's family to use the residential premises after acquisition by the purchaser. The list of persons retaining such right of use is an essential condition of the residential property sale and purchase agreement; and
- the foreclosure procedure upon the residential property owned by an individual is permitted solely upon the court's judgment.

Residential premises are not permitted to be used for purposes other than living unless a designation of the premises is officially changed to non-residential property; the change from residential to non-residential must be carried out upon application by the owner in accordance with the procedure defined in the Housing Code. There is no difference between commercial and residential property regarding tenancy interests in real estate except for certain restrictions in respect of residential premises, for instance, special-purpose residential premises. However, unlike Russian citizens, foreign nationals are not eligible for certain social benefits and cannot acquire ownership or tenancy rights to residential premises intended for vulnerable categories of people, including ones provided for under agreements on social lease conditions.

The Registration Law coming into force on 1 January 2017 allows for compensation in an amount not exceeding 1 million roubles, at the expense of the Russian Federation, to be paid out for loss of title to residential premises by:

- an ex-owner who, for reasons beyond one's control cannot reclaim his or her lost title from a bone fide acquirer of the premises; and
- a bone fide acquirer from whom title to the premises acquired is forfeited by the owner who lost his or her title to the premises prior to its acquisition by the bone fide acquirer.

11 Planning and land use

How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

Construction, reconstruction, capital repair works and exploitation of real estate objects, territorial planning, urban development zoning documentation, and architectural construction design are regulated by the Urban Development Code and urban by-laws enacted in regions of the Russian Federation.

Construction of real estate objects is based upon the protection of existing cultural heritage objects and special natural protected areas, and upon the preservation of the environment.

Construction of real estate is conducted on the territory of land specially designed and lawfully held by the developer on the basis of construction permit issued by the authorities in accordance with the registered project documentation.

Certain types of works on projection, construction, and reconstruction of real estate objects shall be performed solely upon a certificate on admission to such works that is issued by one of the self-regulatory organisations of constructors.

In Russia, all the land is categorised into various zones. Each zone has a special land use regime that comprises certain parameters and limitations on the use of the land, technical conditions for utilities connection and on the buildings that are permitted to be built in each zone. The document that prescribes such limitations is referred to as the 'urban land development plan'. The rules on the use of land are contained both in the Land Code and in the Urban Development Code. On 24 December 2014, the types of permitted land use were determined by Classification of permitted land use, approved by Decree of Ministry of Economic Development No. 540, dated 1 September 2014. There are also other restrictions in respect of the circulation of certain categories of land lots, location of land lots in water-protection zones or in any other territory with a special use regime, as well as with regard to compliance with requirements on environmental protection and technical safety.

On 1 January 2017 the data on the borders of different zones, special territories, water areas, etc, as well as data on land plans, will become available on request from the URR.

12 Government appropriation of real estate

Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

The seizure of land, including by repurchase, is carried out on condition of preliminary and equivalent compensation and such seizure is permitted in the following cases:

- fulfilment of international obligations of the Russian Federation;
- construction and reconstruction of state and regionally significant objects in the event of a lack of any possible alternatives; or
- in any other cases laid down by the federal laws.

The entire legal regime for land seizure for government or municipal needs and the subsequent appropriation of real estate is regulated by the CC and the Land Code, covering the grounds, procedure for such seizure or condemnation (ie, competent state, regional or municipal authorities, seizure conditions, period of seizure, the order of decision-making or application for seizure), the real estate seizure agreement, compensation of losses, etc. According to statutory rules, the amount of compensation for the real estate to be seized shall include both the market price of the real estate to which the ownership right is to be terminated or that of other interests in real estate based upon appraisal report and losses caused thereby.

There are two means of real estate government appropriation:

- by the real estate seizure agreement; or
- upon a court decision (if the landholder does not enter into the real estate seizure agreement). The limitation period for the claim on compulsory seizure is three years commencing on the day the seizure decision was adopted.

The land seizure procedure by the agreement includes the following steps:

- making a seizure decision for public needs either on the application of an authorised organisation, competent government body or after detection of the land subject to appropriation via publication of information about supposed seizure (no later than 60 days before decision has been made);
- carrying out cadastral works with regard to the land if required;
- execution the real estate seizure agreement between the owner or title-holder of the real estate appropriated and authorised state body;
- payment of compensation for the real estate seized or, if there is the owner's consent, granting the land or real estate, or both, instead of appropriated ones; and
- termination of legal title to the seized real estate and registration of conveyance of right to the real estate.

The agreement on real estate seizure shall contain the following information:

- name of the parties:
- cadastral number of the real estate to be seized;
- purpose of seizure;
- rights to the real estate to be terminated;
- requisites of appropriation decision;
- compensation amount and methods of its payment or cadastral value of substitute real estate;
- term of real estate alienation; and
- information about easements (if applicable).

The appropriation of land is carried out together with real estate situated on such land simultaneously.

Federal Law No. 354-FZ of 3 July 2016, on Amendments to Russian Legislation Concerning Improvement of the Seizure Procedure for Agricultural Purpose Land Used in Nonconformity with its Intended Purpose or with Violation of Legislation, envisages provisions that specially regulate seizure of agricultural land. This law introduces administrative responsibility for not using the agricultural land in accordance with its special purpose within one year from the date of the title's acquisition or for improper use of the land in nonconformity with its intended purpose or with violation of law within a specified period of time, information about which is obtained by the competent authority. The relevant fines are calculated as follows:

- for individuals: from 0.1 to 0.3 per cent of the land's cadastral price;
- for legal entities: from 1 to 6 per cent of the land's cadastral price.

Agricultural land, excluding mortgaged land or the land whose owner is in bankruptcy proceedings, can be seized by the court provided the landholder has not eliminated the improper use of the land or the violation of the law during the term defined by the act on administrative responsibility applied to the owner. The seized agricultural land must

be sold via public tender upon the court's decision in the manner provided for by law.

Another way of condemnation on the basis of compensation is a requisition that is applied in cases of national disasters as an extraordinary measure. If the property has been preserved, the owner may bring to court a claim to return the property.

The seizure of property from foreign investors is not allowed except for cases stipulated by federal laws or by international treaties of the Russian Federation and is subject to fair compensation.

In accordance with article 239.1 of the CC, uncompleted construction objects located on state or municipal land, in event of termination of the state-owned land lease agreement, shall be publicly sold upon a court judgment.

Russian law does not contain rules concerning the valuation of competing interests and the allocation of compensation.

13 Forfeiture

Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

Pursuant to article 243 of the CC property including real estate can be confiscated from the owner, without payment of any compensation as a sanction for committing separate crimes or offences in accordance with the Code on Administrative Offences and the Criminal Code. The confiscation is carried out on the court's decision.

According to article 222 of the CC as amended, the building, or any other real estate object, may be declared an unauthorised construction under certain conditions, for example, if the land is not designated for construction, or the construction object has been built without the necessary permits or in violation of construction rules. The consequence of the unauthorised construction will be termination of the owner's title to the property. However, under the rules of article 222 CC the title to such unauthorised construction may be recognised by a court for the owner or any other legal holder of the land where the real estate is located under certain conditions specified by the law, for instance: compliance of the construction object to certain requirements; the land rights allow construction; and absence of a threat to life, health and risk of damage to third parties with the reimbursement the developer against any construction costs. Paragraph 4 of article 222 establishes the possibility of administrative (non-judicial) demolition of an unauthorised building located on land that is not designated for use (ie, if the land plot is situated within the zone of special territories, cultural heritage protection ones, public areas or areas intended for public utilities at federal, regional or municipal level). In Moscow the demolition of the real estate shall be conducted in accordance with Moscow Government Decree No. 829-PP of 8 December 2015 concerning unauthorised construction. Note that, in accordance with the Ruling of the Constitutional Court of the Russian Federation dated 27 September 2016, a local authority's decision on demolition of a building overriding an earlier court's reasoning upon which a claim of unauthorised construction had been denied shall manifest disregard of mandatory legal effect of the court judgment and shall not be regarded as corresponding with the constitutional right to judicial protection.

14 Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency system in your jurisdiction.

Russian law stipulates the possibility of the bankruptcy of legal entities and individuals.

The grounds on which a debtor may be declared bankrupt by a court, the manner in which the relevant procedures are to be carried out and the terms of such procedures, as well as other relations ensuing from the debtor's inability to satisfy creditors' claims completely are set out in the Federal Law on Insolvency (Bankruptcy Law). The provisions of that law will apply to any relations involving foreign persons as creditors, unless an international treaty to which the Russian Federation is a party provides otherwise.

Bankruptcy cases are handled by arbitrazh courts. A motion for bankruptcy may be filed with the arbitrazh court by the debtor, the creditors in bankruptcy (creditors on monetary obligations) and competent government and municipal authorities.

The following procedures apply in bankruptcy proceedings against a corporate debtor: supervision, financial rehabilitation, external management, competition procedure and amicable settlement.

Once supervision has been ordered, this will, inter alia, result in a suspension of any foreclosure proceedings against the debtor's property.

Once financial rehabilitation or external management has been ordered, a moratorium on creditors' claims out of monetary obligations will be imposed, except current payments; also, property foreclosure proceedings are suspended, and damages or other financial sanctions will not accrue. Interest will accrue on the bankruptcy creditor's claims at the refinancing rate set by the Central Bank of the Russian Federation, which will only be paid simultaneously with the satisfaction of creditors' claims out of monetary obligations.

The Bankruptcy Law determines the priority of creditors' claims and the manner in which they are to be satisfied after the debtor has been adjudicated bankrupt and the compensation procedure has commenced; it also defines the priority and the order of the debtor's property valuation in the bankruptcy proceedings.

See question 42 for the special legal status of creditors whose claims are secured by collateral. The claims of any other creditors (purchasers, sellers, lenders) of the person declared bankrupt shall be included in the register of claims and must be satisfied in accordance with priority set forth by the Bankruptcy Law.

Under the Bankruptcy Law the management bodies of the debtor are not allowed to take a decision on reorganisation from the date of supervision. In the course of financial recovery the debtor is entitled to take a decision on reorganisation and put the property to trust management upon consent of the creditors' meeting. From the date of external management the powers of the debtor's management bodies cease.

In respect of the bankruptcy of developers, legal entities or individuals who are creditors in investment in construction of residential real estate receive priority in the satisfaction of their claims. These claims are satisfied at the third level before claims at the fourth level involving claims of other commercial creditors.

The developer's transactions for financing uncompleted construction and ones for terminating mutual parties' obligations may be challenged in court in the course of the bankruptcy proceeding if:

- funds paid by shared construction participants are spent in violation of the Federal Law on Participation in Shared Construction;
- the price and any other conditions of the transactions are significantly worse than those of similar transactions; and
- funds received for the purpose of financing uncompleted construction are used in violation of the rule according to which a special bank account must be used for disposal of such funds and any withdrawal from such account must be made solely upon the bankrupt estate manager's consent or instruction.

According to the Bankruptcy Law, creditors are entitled to file a bankruptcy claim against the debtor without any preliminary debt recovery procedure at a court. The debtor's CEO is obliged to notify all creditors of the bankruptcy status no later than within 10 days of the moment when the CEO becomes aware or should have known about such status.

Investment vehicles

15 Investment entities

What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

There is no concept of investment entities in Russian Law. In practice, joint-stock companies and limited liability companies are the main forms of business entity as they offer their members (beneficiaries) the highest degree of ultimate protection from becoming liable for the company's obligations. As a rule, members (shareholders) may be brought to subsidiary liability for the company's obligations only if the company goes bankrupt through their fault.

The tax treatment to which a company will be subject does not normally depend on its legal form, but may change depending on its area of activity or on the way in which such activity is organised. In Russia, joint-stock and unit investment funds may be established in accordance with the Federal Law on Investment Funds. Activities conducted

via such funds have enjoyed certain tax preferences, in particular transactions with units in such funds are exempt from value added tax.

On 1 September 2014, new provisions of the CC on legal entities came into effect, abolishing some of the previously existing forms of legal entities, namely additional liability company and closed joint-stock company are no longer provided for; in addition, the separation of joint-stock companies into 'open' and 'closed' has been excluded from the CC. Under the new rules all legal entities, commercial or non-commercial, are divided into corporations and unitary entities; joint-stock companies are classified as public and non-public. Legal entities that are non-commercial organisations can be incorporated only in the legal form specified in the CC's exhaustive list, to which state corporations were added on 2 October 2016.

In view of the changes introduced in the CC from 31 January 2016 the founders (participants) of non-commercial corporations, funds and autonomous non-commercial organisations are entitled to withdraw from these organisations at any time without the consent of the remaining participants by written notice to the registration authority, and equally consent is required to join such a non-commercial organisation.

Under the Federal Law on Investments into Strategic Companies agreements on acquisition (purchase), lease or any other such transactions, made by foreign investors with regard to the property classified as the company's main business asset and whose value comprises 25 per cent or more of the company's balance assets value, estimated on the basis of the accounting data over the last reporting period are subject to preliminary approval by the Federal Antimonopoly Service.

The Russian legal system does not provide for the existence of pass-through entities. However, Russian tax law contains provisions that allow for income (dividends) received by Russian residents from their shareholdings in other entities to be effectively exempted from double taxation.

16 Foreign investors

What forms of entity do foreign investors customarily use in your jurisdiction?

Foreign-investor entities may be established in any legal form provided for by Chapter 4 of the CC in relation to business entities.

The most popular legal forms and the ones best aligned with investment-related goals in Russia are the joint-stock company and the limited liability company. Joint-stock companies are covered by more developed legislation and wider court practice. Limited liability companies benefit from a relatively simple incorporation process (as there is no requirement to register a share issue) and lower publicity requirements (compared with joint-stock companies). The law establishes a certification requirement for the minutes of meeting of a legal entity: in respect of public joint-stock company, by the company's register; in respect of non-public joint-stock company, by the company's register or by notary public; in respect of limited liability company, as a general rule, notary certification is applied. The advantage of using a limited liability company is the possibility to exclude the notary certification requirement by signing the minutes of the meeting by all the participants or by any other lawful way set out in the articles of association or unanimously agreed by the participants.

17 Organisational formalities

What are the organisational formalities for creating the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

In Russia, state registration of foreign-invested business entities is handled by the Federal Tax Service (FTS), as established by the Federal Law on State Registration of Legal Entities and Individual Entrepreneurs.

For this purpose, the following documents need to be filed with the FTS local office:

- application for state registration, signed by the applicant (applicant's signature must be attested by a notary public);
- decision to incorporate the entity;
- constitutive documents of the entity being incorporated;
- extract from the foreign legal entities register showing the incorporated foreign entity's legal existence; and
- evidence of stamp duty payment.

All foreign documents are accepted if duly legalised or apostilled, unless otherwise provided for by an international treaty to which Russia is a party, together with a properly certified Russian translation.

The foreign company's branch operating in the Russian Federation shall file an accounting report with the tax authorities, and failure to submit reporting documents stipulated by tax legislation shall lead to termination of its accreditation upon the decision of federal state body. Since 10 April 2016 a foreign company's branch is liable for gross violations of compliance with accounting report requirements in accordance with Code of Administrative Offences of the Russian Federation, in the form of a fine for the CEO or company officials of 5,000 to 10,000 roubles.

Russian tax law does not provide for any differences in taxation depending on the type of entity. According to the Tax Code income received by a foreign participant or shareholder of a Russian organisation, from sale of shares in such organisations in which 50 per cent of assets directly or indirectly consist of real estate situated in the Russian Federation shall be regarded as income from a source located within Russia.

Acquisitions and leases

18 Ownership and occupancy

Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

In addition to the ownership right, the CC provides for the following types of proprietary rights:

- right of life inheritable possession of land from state or municipal ownership (this right was provided to citizens before 30 October 2001, when the Land Code came into force. Existing rights of life inheritance possession do not cease and may be re-registered as an ownership right at any time with no time limit);
- right of permanent possession of land from state or municipal ownership (this right is provided to state and municipal institutions, governmental enterprises, state or municipal authorities);
- easements (right to limited use of alien real estate is obtained under agreement with the owner or upon the court decision); and
- right of economic maintenance (right of state and municipal enterprises to their property) and right of operative management of the property (right of institutions to their property).

On 1 March 2015, proprietary rights such as right of life, inheritable possession of land and right of permanent possession of land were excluded from the Land Code. Therefore the CC (article 216) does not correspond with provisions of the Land Code. Under Russian law, the Land Code has priority over land rules contained in other federal laws.

The ownership right grants its holder the full range of powers: possession, use and disposition, and it is absolute (ie, it has effect against all third persons). The owner is entitled at his or her own discretion to commit any actions with his or her property if such actions are in conformity with laws and regulations and do not violate rights or interests of third parties, including the right to alienate his or her property to third persons, to transfer powers of possession, use and disposition of the property without deprivation of the owner's title, to put on the property any encumbrances including mortgage interest or otherwise dispose of his or her property.

Russian civil legislation sets out the notion of 'common property'. The property may be held in common, with shares of each co-owner in the ownership right (common shared property) and without shares of each co-owner (common joint property).

Russian law does not determine a special right of possession or occupancy.

Apart from the ownership right a lease is not referred to as a proprietary right (it is a contractual right). Nevertheless, the tenant as a legal holder of title has all proprietary remedies from any violations as connected or not connected with deprivation of possession including against the owner. The real estate lease agreement can be short-term for a period not exceeding one year (is not subject to state registration)

and long-term for period over one year (is considered as concluded from the moment of state registration).

The other customary types of lease comprise: an enterprise lease agreement, preliminary lease agreement, residential property lease agreement and financial lease agreement. In Russia there is no master lease agreement per se but the tenant is entitled to conclude a sublease agreement upon the landlord's consent for a period not exceeding the term of the lease agreement. Russian law does differ between residential and non-residential property including in relation to retail, industrial and office premises. For instance, the term of a residential property lease agreement may not exceed five years and such agreement shall specify the persons residing together with the tenant.

19 Pre-contract

Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

In practice parties to civil relations in Russia make active use of memorandums of understanding to fix their preliminary arrangements at the negotiation stage. However, such memorandums may not necessarily have any legal meaning or offer judicial protection. They may be legally binding upon the parties only if they qualify under all aspects of the 'preliminary agreement' concept as defined by article 429 of the CC, that is, the preliminary agreement shall be executed in the form prescribed for the main agreement and shall contain the subject matter and conditions of the main agreement, which shall be agreed by the parties upon a demand by any one of them. The main agreement shall be executed within the term indicated in the preliminary agreement, or in the absence of this term within one year from the date of the preliminary agreement. Court practice characterises the preliminary agreement fixing the real estate purchase price as the future real estate sale and purchase agreement (clause 8, Ruling of the Supreme Arbitrazh Court Plenum No. 54 of 11 July 2011).

If an appropriate legally binding agreement has been entered into, any of the parties thereto may file a court claim for the enforcement of the avoiding party's obligation to enter into the main agreement. Article 429 of the CC provides for a six-month term within which a party may file a claim to compel the other party to execute the main contract. This term starts after failure to fulfil the obligation to execute the main contract. The party that unreasonably avoids entering into the agreement must indemnify the other party for any loss caused thereby. If there are any disputes between the parties with regard to conditions of the main contract, such conditions shall be determined in accordance with court decision, In such a case the main contract shall be deemed as executed from the moment when the court decision entered into force or from any other moment specified in the judgment. The law stipulates a six-month period for pre-contractual disputes to be submitted to the court, upon expiry whereof such disputes are not subject to court trial.

Another agreement entailing legally binding consequences is an agreement on option rights (article 429.2 CC), under which one party by virtue of an irrevocable offer entitles another party to enter into one or several agreements upon the conditions provided by the option. It is also possible to enter into a framework agreement (article 429.1 CC), defining general conditions of relations between the parties, which may be detailed and specified by separate agreements.

The new article 434.1 of the CC introduces liability for conducting unfair negotiations in entering into an agreement. The party that is in bad faith at negotiation shall indemnity the other party against losses caused by such unfair negotiations. The law envisages the possibility of pre-contractual agreement on negotiation that may specify requirements for bone fide conduct at the negotiation stage, allocation of negotiation costs, and any other respective rights and obligations. As a general rule, the party receiving confidential information shall not disclose such information or not use such confidential information for its own purposes. The party that has violated the confidential obligation shall indemnity the other party against losses caused by disclosure.

In Russia, a letter of intent is not common, compared with a term sheet, at the negotiation stage of a real estate contract of sale.

It is common practice in Russia to take the property off the market while negotiations are under way; however, this condition will not bind the vendor unless it is incorporated in the preliminary agreement.

20 Contract of sale

What are typical provisions in a contract of sale?

The agreement must be executed in writing as a single document signed by the parties.

The agreement must include the following material terms and conditions:

- the subject-matter provision, that is, identified details of the real estate, including property location within the respective land plot or within another item of real estate;
- real estate price; and
- in the case of residential property sale, a list of persons who by operation of law retain the right to enjoy such property after sale, with their rights indicated.

The parties are free to set up any other terms and conditions in the agreement at will, provided such terms and conditions are not contrary to the laws of the Russian Federation. If the terms and conditions of the agreements are not set forth by the parties or by the dispositive norm, such conditions shall be determined by customs applicable to the relationship between the parties.

Current Russian law and practice do not provide for any requirements as to the standard first payment under an agreement, the parties negotiate this issue individually and on a case-by-case basis; in most instances, agreements do not provide for instalments. Escrow accounts are not regulated or widely used in Russia. Most commonly, advance payment is effected by either a direct payment to the vendor, or the purchaser opening a letter of credit for the agreed amount in the vendor's favour.

The main documents that evidence legality of the vendor's possession of real estate are the certificate of title state registration to the respective real estate issued prior to 15 July 2016 and extract from the URR, issued by Rosreestr. After 15 July 2016 the sole evidence of the real estate title's acquisition and transfer will be the extract from the URR; the certificate of real estate title registration will no longer issued. Registration of any real estate agreement will be certified by a special stamp of the registration authority on the document expressing the transaction content.

The parties to the agreement are free to determine who will bear the title-checking expenses, and the contents of the guarantees and statements regarding the title. According to new provisions of the CC, which came into force on 1 June 2015, the party that has given false representations is obliged to indemnify the other party's losses resulting from breach of representations (article 431.2). In addition, under these amendments to the CC parties may envisage in their agreement a duty of one party to compensate the other party's proprietary losses in the event of occurrence of certain circumstances, for instance, the impossibility of obligation performance, state authorities' claims addressed to the party, etc (article 406.1). As a general rule, unless otherwise agreed by the parties, the tax and utility liabilities in relation to the real estate sold, as well as the risk of its loss or damage, will pass to the purchaser upon the title's acquisition. Respectively, the risk of loss will remain with the vendor until deal closure.

The tax period in the Russian Federation is equal to the calendar year (1 January to 31 December).

21 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

As a general rule, liability for any damage to the environment caused by the operation of real estate may be enforced against the person who possessed such property at the time the damage occurred.

Russian law and practice do not contain any specific provisions concerning responsibility for future environmental clean-up. However, the vendor must deliver the property to the purchaser in a proper condition that, in particular, conforms to environmental safety requirements. If the vendor made no reservations as to any defects in the real estate, the purchaser who received delivery of the substandard property may at its option require from the vendor either a commensurate rebate on the acquisition price, or rectification of such defects at no additional cost, or reimbursement of its own costs of rectifying such defects, and in cases of material breach of quality requirements, may reject performance of the agreement and request a refund of the amount paid.

In addition, pursuant to the general rule of article 15 of the CC, the purchaser of real estate, who suffered loss by reason of the seller's failure to ensure that the property in question conforms to environmental safety requirements, may demand recovery of the full amount of such loss from the vendor.

Owing to the changes introduced in the Federal Law on Protection of the Environment, from 1 January 2016 payment for adverse effects on the environment is divided into three types: pollution emissions, water waste and industrial production waste. This duty shall be paid by legal entities and individual entrepreneurs carrying out business activity within the continental shelf or the exclusive economic zone of the Russian Federation and in respect of waste disposal by any legal entities and individual entrepreneurs whose business activity produces waste. The amount is calculated upon the formula stipulated by law and shall be paid no later than 1 March of the year following the reporting year. If the duty for adverse effects on the environment is not paid in full or is overdue, a penalty of 0.03 per cent of the rate set by the Bank of Russia for each day shall be accrued.

22 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

Russian law does require a seller to transfer the property free from any rights of third parties. The failure to fulfil this duty shall entitle the buyer to demand a reduction of the price of property or termination of the contract of sale, if it is not proved that the buyer knew or should have known about the third-party rights thereto.

Parties to the agreement are, however, free to determine the scope and content of any such representations and incorporate appropriate clauses (as long as they are not contrary to law) in the preliminary or main agreement, or both. A property vendor will normally represent to the purchaser as to whether there exist any outstanding obligations related to property enjoyment, and as to the existence, scope and terms of any continuing lease agreements.

Leased property title transfer to another person is not a cause for amendment or termination of the lease agreement.

Normally, the parties to a real estate sale agreement will agree on a standstill in relation to any existing lease agreements until deal completion. The parties further may provide in the preliminary agreement for the property vendor's duty to cancel any existing lease agreements before the main agreement is concluded; however, the purchaser's only remedy if this condition is not complied with will be to reject entering into the main agreement or to receive liquidated damages from the vendor.

Any intermediary agreements (including real estate broker agreements) concluded by the vendor will not pass on to the real estate purchaser, unless the parties consent to a novation agreement.

Tenant certification has not been subject to any legal or practical regulation.

23 Leases and real estate security instruments

Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

Russian law does not restrict the owner of leased property in its right to pledge such property with third parties. However, the landlord is obliged to notify the tenant at the time of entering into a lease agreement of any third-party rights over the property being leased (including any security interests). A landlord's failure to comply with this duty will entitle the tenant to demand a rent rebate or lease termination and indemnity of damage.

The transfer of title to the property on lease is not the cause for the termination or variation of the mortgage's interest in such property except for acquisition of the mortgaged property by a bone fide purchaser unaware about mortgage interest, realisation of the property in mortgage upon foreclosure or alienation of commodities in circulation.

At the time of entering into a mortgage agreement, the mortgagor must notify the mortgagee in writing of any third-party rights over the mortgaged property (including lease rights) known to it by the time of entering into the agreement. Failure to comply with this duty will entitle the mortgagee to accelerate the obligation backed by the mortgage or vary the mortgage agreement terms and conditions unless otherwise stipulated by law or the parties' agreement.

The mortgagor may not alienate the mortgaged property to a third party without the mortgagee's consent unless otherwise is provided for by a law, agreement or being inferred from the substance of mortgage. Failure to obtain the mortgagee's consent on an alienation transaction shall terminate the mortgage and entitle the mortgagee to demand reimbursement of losses resulting from such unauthorised alienation. The right to lease out or otherwise enjoy the mortgaged property is not restrained by obtaining the mortgagee's consent if it is otherwise not stipulated by law or mortgage agreement. If the mortgagee forecloses on the mortgaged property, all lease rights in relation to such property granted by the mortgagor to third parties without such mortgagee's consent shall be subject to termination.

Russian law does not provide for any priority between the tenant's right and any security interest created over the property leased by it. The only exception is the mortgage interest to which the lease is subordinate. Upon transfer of title to the mortgaged property, the tenant must pay rent to the new owner by law. This requirement may not be changed by agreement. The same effect of retaining legal force after transfer of title to real estate has a security interest in real estate with exceptions specified within the provisions of the CC – termination of the mortgage interest in real estate in the event of acquisition of the mortgaged property by the bona fide purchaser.

The Land Code of the Russian Federation states that in relation to state or municipally owned land on ground lease for a period exceeding five years, the tenant is entitled to transfer rights and obligations under the lease agreement, including encumbering the tenant's rights by security interests or transfer the land on sublease without the lessor's consent on the condition of notice to the owner. Moreover, such ground lease agreement may be terminated by unilateral act of the landlord solely upon a court judgment in the event of material breach of the agreement. A ground lease agreement as a long-term one must be registered. In other aspects Russian law does not differentiate between ground leases and other commercial leases.

24 Delivery of security deposits

What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

In Russian practice, parties to civil relations entering into property lease agreements often use 'security deposits' to secure the tenant's obligation to enter into the lease agreement and pay rent and repair damage. Article 381.1 of the CC introduced the 'security deposit' as a means of securing performance of payment obligations, for instance, to

compensate losses or pay forfeit (penalty) upon breach of agreement. As a general rule, the landlord shall return the security deposit to the tenant upon termination of the lease agreement provided the tenant has not violated its obligations.

Any security deposit amounts received by the property vendor from tenants under lease agreements must, as a general rule, be either transferred by the vendor to the purchaser or refunded to the tenants after the property title transfer. The parties to a sale-purchase agreement may agree on the procedure and terms of such payments. No special legal regulation exists in this area.

While Russian law does not in any way restrict the use of letters of credit to pay security deposits, this practice has not become common in Russia. Long-term property lease agreements in Russia will in most cases contain clauses providing for periodic rent reviews in relation to any changes in the landlord's property maintenance expenses. However, such changes may not be effected more than once a year.

25 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain a zoning report or legal opinion regarding legal use and occupancy?

Russian law does not regulate either the process or the consequences of due diligence. At the same time, some practice in using this concept has already evolved. Russian courts tend to treat due diligence in the course of sale and purchase as a business custom.

Any documents and information necessary to check the property title and acquisition or enjoyment terms and conditions will, as a rule, be provided by the property vendor. In addition, alternative information-gathering methods are frequently used, such as: inquiries with various authorities, in particular obtaining extracts from the URR, obtaining and analysing publicly available information (including that posted on websites of government supervisory bodies and courts).

Based on the due diligence results, lawyers will issue an opinion with information on the property status, documents and titles researched, and any issues or risks identified. Such a document, however, will not be of any legal significance as protection for the purchaser if a defect in title is identified.

Russia's legal system prioritises those rights to real estate that passed the statutorily required state registration in the URR. Documents evidencing state title registration are recognised as the only indisputable evidence of such title. A registered title may be challenged only in court. According to the new Registration Law initiating a trial in relation to real estate will not entail refusal to register transfer of the real estate title or any real estate transaction.

Recent Russian practice has shown the growing popularity of the title insurance concept (ie, insurance against the risk of losing title to real estate, in particular, as the result of deal invalidation or vitiation). However, legal remedies available to the policyholder remain ambiguous. Rare court practice links them to the mandatory presence of appropriate insurance terms and conditions in the insurer's rules of underwriting.

Russian legislation envisages regulation of the indemnity (article 406.1 CC). This instrument may also be used in real estate sale and purchase agreement governed by foreign law, especially by English law.

Under the new Registration Law, earlier registered rights to real estate have priority over rights registered later, and in the event of any inconsistencies between these rights the registration body shall suspend registration of the right to real estate in the event of discovering an already registered right to real estate as specified in the application (article 26 of the Registration Law). The rules on the priority of rights are compulsory and cannot be changed upon the parties' agreement. Legal opinion is commonly used in real estate transactions. The aim of legal opinion is to identify and assess all risks associated with real estate title, acquisition, operation and exploitation.

The zoning plan is the main document issued by local authorities that reflects the actual status of permitted land use and zoning and it is essential to find out whether there are any restrictions in relation to construction or special regimes of business activity that can be conducted within a given area before a decision to acquire real estate is made.

With a mortgage the mortgagee has the right of priority over any other lenders to obtain satisfaction from the cost of collateral. However, transfer of title to collateral to the other person as a result of alienation or succession of the mortgaged property, except for foreclosure upon it or its acquisition by bona fide purchaser, does not serve as a ground for lease termination.

26 Structural and environmental reviews

Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

In Russia, a practice exists of conducting engineering and environmental reviews and issuing appropriate reports in advance of estate property acquisitions; however, the law provides for no regulation on the reporting procedure, content or consequences.

The concepts of representations and indemnity are, now, recognised by Russian Law. A general rule applies whereby loss caused by breach of the property quality conditions, which may include environmental and engineering requirements, is to be indemnified.

Russian law provides the opportunity of insuring against the risk of liability for environmental damage.

Obtaining zoning documents and legal opinions by the purchaser of real estate is widespread but not mandatory.

27 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

Leases are reviewed by lawyers (concerning execution, presence of material and other relevant conditions) as well as economists (concerning amounts, reasonableness and frequency of payments and expenses). Lawyers would normally note, in particular, the clauses regulating the procedures for rent payment, rent review, lease extension and tenant's priority rights, as well as those governing lease termination, rules of usage, permission to install lease property improvements and reimbursement of related costs. Russian law provides a mandatory rule that a lease is subordinate to a mortgage.

In Russia a management agreement is not regulated by statutory civil law and in practice such agreements are entered into to govern maintenance, operation and exploitation of the real estate along with long-term lease agreements and contracts of sale concluded in respect of retail buildings and large trade and office complexes. The law does not require that management agreements be subordinate to mortgage or any other security instruments and does not specially regulate management agreements in relation to commercial property, in comparison with those concluded in respect of residential property: for instance, an agreement for the management of a multi-apartment residential building shall be executed between a special licensed management company and the owner of the residential apartments and shall contain conditions specified by the Housing Code.

28 Other agreements

What other agreements does a lawyer customarily review?

Within a check of real estate title and acquisition or usage conditions, lawyers would normally review all related agreements providing transfer of, or any limitations on, the possession, usage or disposal rights, including pledges, leases, and property management agreements. Conditions of intermediary agreements or service agreements, which had been concluded by the vendor, will be of relevance for the purchaser if the parties have agreed on a transfer of the rights and obligations under such agreements to the purchaser.

29 Closing preparations

How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

Closing of a real estate sale or purchase deal implies:
- state registration of the purchaser's title to the property (ie, of title transfer to the purchaser);
- transfer of a real estate by signing the deed of transfer; and
- complete payment of the acquired real estate price by the purchaser.

Closing of a lease transaction implies:
- transfer of real estate by signing the deed of transfer;
- state registration of lease agreement (if applicable);
- complete payment of advance rental payment (if such provision is determined by the agreement); and
- complete payment of the security deposit by the tenant.

Closing preparations for financing real estate transaction depend on a settlement order agreed by the parties (a letter of credit, a bank deposit box, etc) and usually include:
- opening a letter of credit at an authorised bank or signing a lease agreement in relation to bank deposit boxes;
- placement of cash in bank deposit boxes; and
- the seller's access to bank deposit boxes and withdrawal of cash from bank deposit boxes.

The financing source will normally check for good title and whether the vendor's corporate approvals, documents confirming powers or capacity of the parties or their representatives to enter into a legally binding agreement, compliance with pre-emptive right to purchase the property, the third party's prior consent and state body's permission as required by law, are available. Appropriate documents are then drafted. Real estate is very often acquired by purchasing the entity owning such asset, and in this event a wide list of documents is provided in relation to the legal status and financial position of the acquired entity.

Unless otherwise provided for by federal law or agreement the real estate acquired using credit funds or special purpose funds extended to finance such acquisition will be deemed to be mortgaged with the creditor (lender) from the moment of state registration of the borrower's title to such real estate.

Prorations are virtually never used in real estate transactions.

The closing date may coincide with the moment of payment of real estate price or moment of state registration of transfer of title to real estate. Unless otherwise provided in the agreement, the real estate sold on credit or by instalments is deemed as being mortgaged with the vendor from the moment of its transfer to the purchaser until full and final payment.

30 Closing formalities

Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

Russian law does not require the personal presence of all parties to the agreement or any other third persons (public officer or a special licensed agent) upon execution of the agreement, transfer of title, leasing or financing.

If the transaction has to be certified by notary, the documents must be signed in the presence of a notary public. The transaction shall be executed at the notary's location. As of 15 July 2016 the real estate transaction must be certified by a notary public in the notarial district in the Russian region where the real estate is located or in any Russian region if the property is situated in various regions. There are no other special requirements applicable to notarial actions.

31 Contract breach

What are the remedies for breach of a contract to sell or finance real estate?

If the seller (or the landlord) fails to transfer a title to real estate (or right of use) to the purchaser (or the tenant), the latter is entitled to terminate the agreement and demand compensation for losses caused by the contract breach. In event of the seller's non-performance of the obligation to transfer individually defined property, the other party is entitled to demand transfer of the property to itself in accordance with the conditions of the agreement. This right is not enforceable if the property has been already handed over to the third party whose title or interest in relation to the disputed property has been already registered. The recourse which is available to the purchaser in lieu of transfer of the property is reimbursement of losses.

In the event of avoidance by one party of state registration of transfer of title to real estate, the other party is entitled to demand registration in court. In the case of avoidance by one party of mandatory notarial certification of the transaction the court can render it valid on the other party's application.

Upon breach of the sale and purchase agreement there are the following statutory remedies available to the non-defaulting party: compensation for losses, payment of penalties and termination of the agreement. If the quality of real estate does not correspond to the conditions of the agreement, the purchaser is entitled to require from the seller at its own option:
- a proportionate reduction in purchase price;
- free-of-charge removal of defects in the real estate within reasonable time;
- compensation for expenses incurred for removal of defects in the real estate; or
- in cases of material breach of quality requirements, the purchaser may reject performance of the agreement and request a refund of the amount paid for the real estate.

Under article 308.3 CC the non-defaulting party has the right to demand in court specific performance from the other party, unless otherwise stipulated by law, agreement or being inferred from the substance of obligation, and in the case of failure to enforce the judgment the court may award for such party monetary compensation in a reasonable amount.

In the event of the purchaser's breach of the obligation to pay the purchase price, the seller is entitled to require from the purchaser payment of money for the property and interest payable by law or withdraw from fulfilment of the agreement. The agreement may determine a penalty for delay in payment. In relation to the property sold on credit the seller may demand payment for the property received by the purchaser or return of the property unpaid.

The purchaser may demand damages from the seller in event of withdrawal of real estate upon any claims of third parties that the purchaser did not know or should not have known or was not aware of.

The purchaser may refuse performance of the agreement in the event of lack of necessary documentation attached to the real estate, failure to convey the real estate, or in any other circumstances stipulated by law.

As a general rule, the limitation period for claims of breach of contract is three years from the moment when the injured party discovered or should have known about the violation of the right and about who is the due defendant. The limitation period may not exceed 10 years from the date of the right's violation.

32 Breach of lease terms

What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply?

The remedies available to both tenant and landlord include: claim for specific performance of obligations under the agreement, termination of lease agreement, indemnification of losses and recovery of penalty.

If there are defects in the real estate, the tenant has the right to demand:
- free-of-charge removal of defects or reimbursement of expenses on removal of defects;
- deduction of the expenses incurred on the removal of defects from the rental payment; or
- early termination of the agreement.

In case of the termination of the agreement the tenant is entitled to demand reparation of losses caused by violation of the agreement and subsequently its termination.

The list of grounds for termination of a lease agreement, both at the tenant's request and at the landlord's request is stipulated in the CC. The landlord is entitled to demand termination of the agreement on the condition of a prior written notice about necessity of fulfilment of obligations within the reasonable period.

The real estate shall be returned to the landlord by the tenant upon termination of the agreement. In case of delay in return of leased property, the landlord is entitled to demand lease payments for the period of delay and compensation for loss (if the lease payment is insufficient to cover all losses) in addition to the penalty if the lease agreement provides for untimely return of the leased property. Moreover, the landlord has the right to release (evict) the ex-tenant from real estate object under general provisions on vindication claim.

In event of infringement of pre-emptive right to conclude a lease agreement for a new term, the tenant is entitled to demand transfer of rights and obligations under the concluded agreement on himself and payment of damages caused thereby.

Financing

33 Secured lending

Discuss the types of real estate security instruments available to lenders in your jurisdiction.

At present, the mortgage is the sole effective type of security interest in real estate.

The mortgage as a security interest arises under the agreement or by law upon occurrence of circumstances specified by law (for instance, purchase of a property with credit entails the formation of a mortgage interest therein in favour of the seller until full payment by the purchaser).

By mortgage the lender (mortgagee) is vested with the right to obtain priority over the other mortgagor's creditors a satisfaction from the price of the collateral in event of non-fulfilment or improper fulfilment of the obligation secured by the mortgage. The parties to the mortgage agreement may ascertain a provision that the mortgagee is entitled to retain the mortgaged property upon foreclosure on the collateral (both in a non-judicial order or in the court).

The notion of 'defeasible conveyance' is unknown to Russian law.

The lien as a security interest is applicable to real estate if the real estate subject to transfer to the debtor is in the possession of the lender. The lender is entitled to retain the property in case of the debtor's failure to fulfil obligations on payment for this real estate or on compensation of any losses associated therewith until complete fulfilment of the obligation. The satisfaction of the claims at the expense of the retained property is conducted in the order applied to satisfaction of the claims secured by mortgage.

The amendments to the Federal Law on Participation in Shared Construction', coming into force on 1 January 2017, introduce an alternative settlement instrument known as the escrow account, to which the buyer shall transfer its payment for a residential apartment. This account may be opened in a special bank which is licensed for such operations. This statutory tool is supposed to act as an insurance against the developer's insolvency or any other risk of investment loss.

34 Leasehold financing

Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

There are several instruments available for financing of ground leases:

- loan; and
- credit granted by banks and other credit organisations.

The duration of financing a lease is not defined by law and in practice is limited to the period of the lease agreement. The maximum term for certain types of lease or lease agreements in relation to certain categories of property may be fixed by law, upon expiry of such term the lease agreement shall terminate. There is no minimum statutory term for a lease agreement, so that parties are free to conclude a lease agreement up to maximum term and, consequently, contract for financing in relation to such a lease. Another possible method for leasehold financing is a leasehold mortgage whereby the lease interest or improvements in the leased property may be mortgaged. As a general rule, the leasehold mortgage requires the consent of the lessor. The exceptions may be set forth by laws or in by-laws, for instance, a ground lease of state-owned land for a period exceeding five years may be mortgaged upon notice of the owner.

The financial lease is prohibited from being applied to any land lease transactions in accordance with Russian law. Financing for land ownership transactions does not differ from leasehold financing relating to land.

35 Form of security

What is the method of creating and perfecting a security interest in real estate?

A pledge may commence by virtue of an agreement or by operation of law. Some instances of such commencement of pledge over property by virtue of operation of law are discussed above. Real estate pledges (mortgages) are regulated by the Federal Law on Mortgages, in addition to the CC.

According to the CC, a pledge agreement must be executed in writing unless the notarised form is ascertained by law or agreement; if the written or notarised form is not complied with, the pledge agreement will be void. The requirement for state registration of a real estate pledge agreement contained in the Federal Law on Mortgages is not applicable to real estate pledge agreements made after 1 July 2014. If the mortgage agreement that is subject to registration by statute does not contain all the conditions stipulated in the Federal Law on Mortgages or does not correspond with paragraph 4 clause 13 thereof, such agreement is not required to be registered.

Under the CC any property (including property rights) may be pledged, except for property upon which foreclosure is not possible, claims that are indivisible from the creditor's personality and other rights that by law cannot be transferred to another person. The agreement or law may provide for encumbrance by pledge of the property or proprietary rights that may be acquired by the pledgor or may arise in future.

The CC envisages the pledge of proprietary rights following from the mortgagor's obligations. The pledge of rights does not require obtaining the consent of title-holder's debtor unless otherwise set forth by law or agreement with the debtor, or the rights are foreclosed. Therefore Russian civil law does provide for bank account pledges; a bank account pledge is accompanied by entering into the pledge bank account the agreement between the mortgagor and the bank acting as mortgagee under which the parties may stipulate that the rights ensuing from the bank account agreement may serve as collateral, in particular the right of the client (account holder) to instruct the bank to transfer or disburse appropriate amounts from that account and perform other account operations.

36 Valuation

Are third-party real estate appraisals required by lenders for their underwriting of loans? Must appraisers have specific qualifications?

A third-party independent valuation of the real estate at the creditor's initiative is a common practice in Russia and is regulated by the Law on Appraisal Activity. The appraisal of real estate is compulsory in cases specified by the law. The valuation of the real estate is conducted for the purpose of determination of its market, cadastral or any other price. The valuation is carried out by individuals, members of self-regulatory appraisal organisations, with a special qualification and whose liability has been insured. With regard to significant amendments to Tax Code, the appraisal is important since the property tax is calculated on the basis of cadastral value of land or any real estate that is much higher than inventory value as applied before. The owner or legal holder of title to the property may file an application for contestation (review) of cadastral value with the court of general jurisdiction under the rules of civil procedure; after 15 September 2015, under the Code of Administrative Court Procedure. Legal entities, state authorities or municipal authorities may bring the application before the court on the condition of compliance with pretrial procedure in the Cadastal

Disputes Solution Committee. The Committee considers cadastral disputes in accordance with procedure prescribed in article 24.8 of the Federal Law on Appraisal Activity. The decisions of the Committee may be challenged in court.

According to recent amendments to the Federal Law on Appraisal Activity in the Russian Federation, which will come into force on 1 July 2017, the appraiser will be required to be professionally certified, which is confirmed by the qualification certificate.

This law specially regulates the cadastral value during the period from 1 January 2017 to 1 January 2020: for real estate whose cadastral value was unavailable or inapplicable on 1 January 2014, the cadastral price on 1 January 2014 or on 1 January of the year when the cadastral price commenced subject to taxation shall be applied; if the cadastral value of such real estate as determined after 1 January 2014 is less than the cadastral price on 1 January 2014 or on 1 January of the year when the cadastral price commenced subject to taxation, the lesser cadastral price shall be applied.

37 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

Russian law does not impose any limitations on, or special conditions for, the granting of bank and non-bank loans by foreign entities, including those secured by the mortgage of real estate located in Russia. Conducting this kind of business in Russia is not subject to any permission, and the foreign entity's duty to pay Russian taxes will only commence if income is received from a Russian source (a Russian borrower entity paying interest to a foreign lender entity under a loan agreement must withdraw profit tax and pay it to the Russian revenue authority unless the foreign individual lender is a tax resident of a foreign state with which Russia is a co-party of an international treaty on taxation providing for full or partial exemption of taxation in respect of respective duty). Security interest formalisation requirements are common for all parties to civil relations (mortgage and real estate pledge agreements shall describe the property mortgaged, substance, amount and term of the obligation secured by the mortgage, conditions of which are deemed as agreed upon if the parties make a reference to the loan agreement).

Stamp duty is payable for the state registration of a mortgage agreement, including making an entry in the URR, in respect of the mortgage, as follows: individuals, 1,000 roubles; legal entities, 4,000 roubles.

Russian law does not prohibit replacement of the mortgagee in consequence of an assignment of claims under the primary obligation secured by the mortgage, or under the mortgage agreement. The stamp duty for the state registration of such a transaction and making necessary amendments to the URR is set at 1,600 roubles.

The stamp duty to change the holder of a note secured by real estate, including the assignment of rights under the transaction and making an entry in the URR of the mortgage's note, is 350 roubles.

38 Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

Unless the law or agreement provides otherwise, interest rates on bank and non-bank loans are agreed upon by the parties in the relevant loan agreement.

If the agreement does not stipulate an interest rate clause, such interest rate will be determined by the bank interest rate (refinancing rate, which is equal to the Bank of Russia base rate at the respective date) prevailing at the lender's place of residence (location) as of the date when the debt principal is repaid by the borrower. Court practices in relation to this rule are diverse but normally the following two alternative interest calculation methods will prevail: based on the refinancing rate set by the Central Bank of the Russian Federation; or based on the average bank interest rate on loans prevailing in the region where the lender is located.

Russian law and practice do not provide any unambiguous definition of an unreasonable high interest rate on loans, or of any consequences of using such a rate. The parties are free to negotiate agreement conditions, except where the content of a particular clause is stipulated by the law or other statutes. As a general rule, however, it is not allowed to use a person's civil rights to limit competition, or to abuse a dominant market position. In addition, a transaction that a person was forced to make by reason of the occurrence of adverse circumstances on conditions extremely unfavourable for such a person (one-sided transaction), may be invalidated by the court in a suit brought by the aggrieved party.

Recent law enforcement practice demands all fees to be included in the interest rate calculation where individuals are concerned. Shared appreciation is virtually never used by Russian banks. Calculation of interest accrued in addition to payable interest (complex interest) is not allowed unless otherwise set out by law or agreement made in business relations. Owing to changes in the Federal Law on Mortgages as of 24 July 2016 the amount of penalty which may be imposed upon individuals in case of default on repayment of the consumer loan (credit) or interest accrued thereto shall not exceed the Bank of Russia base rate on the day when the agreement is entered into or, if interest is accrued to the principal amount for the default period, shall be up to 0.06 per cent of the outstanding sum for each day of the obligation's non-performance.

39 Loan default and enforcement

How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

Russian civil law enables a creditor to recover loss, damages or both in enforcement proceedings in response to a default on obligations. As a general rule, loss will be indemnified in any part that is not covered by the amount of agreed penalty.

The performance of obligations may be secured by penalties, pledge, withholding of debtor's property, surety, independent guarantee, security deposit or other methods provided for by law or agreement. The creditor of an obligation secured by pledge (the pledgee) will have priority over the pledgor's other creditors in satisfying its claims out of the pledged property value, if the debtor defaults on such obligation.

The pledgee's (creditor's) claims will be satisfied out of the pledged property value by court order. A foreclosure proceeding can be initiated by the pledgee on the condition that:

- the amount of default on the secured obligation constitutes more than 5 per cent of the value of the pledged property; and
- the period of delay in the secured obligation exceeds three months.

According to the rules of the CC, the pledgee's claims may be also satisfied out of insurance indemnity, compensation payable instead of the pledged property, revenues received by third persons from use of the pledged property, or the property acquired by the mortgagor from a third party as a result of satisfaction of the rights pledged. However, unless the law provides otherwise (in certain circumstances), the parties may negotiate that the pledgee's claims will be satisfied on an out-of-court basis. This type of arrangement in relation to pledged real estate may be included in the real estate pledge agreement or be stipulated in a separate agreement between the parties. If the pledge agreement has been notary-certified, the foreclosure and subsequent sale of the pledged property shall be carried out upon enforcement of the notarial note. The parties to such arrangement may agree that the real estate will be either sold at a public auction or acquired by the pledgee.

The Federal Law on Mortgages provides for the borrower's responsibility to insure the mortgaged property to indemnify against insufficient value or proceeds of the mortgaged property by way of insurance of the lender's financial risk of loss arising therefrom.

A 'one action' rule or a 'one at a time' rule does not exist in the Russian legal system.

Update and trends

The amendments to the Civil Code of the Russian Federation and the Registration Law, coming into force on 1 January 2017, introduce the notion 'parking space', which was previously not acknowledged in law although commonly used in practice. Thus a parking space is regarded as a separate object of rights referring to the immoveable property as well as residential and non-residential premises subject to the description of its boundaries as specified by law. By legal definition the parking space is a specific part of a building or any construction solely designed for parking a transport vehicle, its boundaries indicated graphically on the ground or the plans. Prior to these rules the legal status of parking spaces was uncertain, as court practice was not uniform providing for various approaches to their legal nature.

In view of the changes from 1 January 2016 under which real estate transactions to be certified by notary were extended to title share sale agreements, contracts on disposal of the property on condition of trust and custody, and sale contracts in respect of real estate owned by minor or partially capable (specially disabled) persons, the role of the notary public may have a significant impact on the whole real estate transaction legal environment.

Federal Law No. 354-FZ of 3 July 2016, on Amendments to Russian Legislation Concerning Improvement of the Seizure Procedure for Agricultural-Purpose Land Used in Non-Conformity with its Intended Purpose or in Violation of Legislation, strengthens the liability for not using agricultural land for its intended purpose or its use in violation of the law, providing for its compulsory seizure and increasing restrictions imposed upon business activity within the agricultural land area, in particular land situated within 30 kilometres from a village's borders is not intended to be used for purposes other than agriculture.

On 1 January 2017 serious amendments will come into force to the Federal Law on Participation in Shared Construction that are aimed at increasing legal protection of the rights of private investors, mainly citizens contributing money to shared construction. In particular, the developer's share capital will be required to be paid in the full amount that is not less than its statutory minimum size; the price will be calculated on the basis of the shared participation object and paid after state registration of the agreement. A new method of payment will be available, such as an escrow account to be opened by the bank providing credit to the developer.

40 Loan deficiency claims

Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

Pursuant to the CC, the proceeds of the mortgaged property after foreclosure proceedings shall be distributed among mortgagees stating their claims, other mortgagor's creditors and the mortgagor. The distribution of the proceeds may be conducted by bailiff, notary officer or administer of public auction.

If the proceeds of the mortgaged property after foreclosure exceed the amount of claim secured by the mortgage, the balance shall be repaid to the mortgagor. If the proceeds of the mortgaged property are insufficient to cover the mortgagee's claim, the mortgagee is entitled to satisfy its claim for the outstanding sum from any other property of the debtor without priority based upon the mortgage. As the Supreme Court clarified, a bailiff is entitled to foreclosure upon the other property of the debtor subject to provision of a recovery debt claim in the enforcement document. The claim for a deficiency judgment can be brought by the lender before the court within the statutory limitation period (three years). According to the rules of the CC on the order of priority in satisfaction of claims upon foreclosure, unless otherwise stipulated by the CC or other law, the mortgagee's claims are to be satisfied on the basis of the moment of occurrence of the mortgage, with certain exceptions laid down by the CC and other laws.

41 Protection of collateral

What actions can a lender take to protect its collateral until it has possession of the property?

Russian law does not recognise the concept of mortgage in possession. The mortgaged property is not transferred to the mortgagee but remains in the mortgagor's possession and use. The mortgagor may use such property in accordance with its intended purpose.

The following actions can be taken by the mortgagee in order to protect the collateral:

- inspection that the mortgaged property has been maintained in good order;
- insurance of the mortgaged property at the mortgagor's expense against risk of loss or damage in an amount not less than the amount of such claim;
- ban on alienation of the mortgaged property to a third party without the mortgagee's consent and on other actions that may lead to loss of the mortgaged property or to reduction in its value;
- taking necessary measures to ensure security of the mortgaged property from third-party intrusion or claims; and
- immediate notification by the mortgagor of any risk of loss or damage to the mortgaged property.

The law does not regulate liability for the lender who possesses the mortgaged property before foreclosure. Pursuant to article 33 of the Federal Law on Mortgages the lender may discharge the mortgaged property from a third party to transfer it to the mortgagor on its own behalf. Moreover, the mortgagee is entitled to all legal remedies available to the mortgagor if the latter refuses to protect its rights.

The mortgagee may inspect documents evidencing physical existence, quantity, state and storage conditions of the mortgaged property.

If the mortgagor fails to comply with the statutory duties on maintenance and safety of the property the mortgagee will be entitled to expedite the mortgage-secured obligation and, in the event of failure to expedite, foreclose the mortgaged property.

Russian law does not define the concept of, or procedure for, administration of the debtor's (mortgagor's) income other than via bankruptcy proceedings and by an administrator (receiver) appointed by the arbitrazh court upon a creditor's motion.

42 Recourse

May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

As a general rule of Russian civil law, borrowers and other parties to civil relations are liable for their obligations to the extent of their entire property. For this reason, if the proceeds of pledged property sale are insufficient for the satisfaction of the pledgee's claim, the latter will be entitled (unless the law or agreement provides otherwise) to recover the remaining amount out of the debtor's other property without invoking the benefits created by pledge.

The pledgee's rights will terminate neither upon initiation of bankruptcy proceedings against the debtor (pledgor) nor after the latter is adjudicated bankrupt; however, Russian law does impose some restrictions on these rights. Pursuant to the Federal Law on Bankruptcy, foreclosure of the pledged property will be suspended as soon as the court orders the supervision procedure against the debtor (the first stage in bankruptcy proceedings). According to new rules that came into force on 15 July 2016, during financial rehabilitation and external management the pledgee may foreclose the debtor's pledged property as follows:

- the foreclosure upon the debtor's pledged property will not entail impossibility for the debtor to become solvent; and
- the debtor's property is at risk of damage thereto owing to which the property' price will significantly reduce, or it is at risk of accidental loss or damage.

The burden of proof of impossibility for the debtor to restore solvency as a result of the foreclosure upon the debtor's pledged property is imposed on the debtor.

Once the court has adjudicated the debtor bankrupt, the pledged property will be sold. The pledgee's claims are included in the list of third priority creditors. After satisfaction of the first and second priority creditors' claims (liability for harm caused to human life or health, wages and authors' compensation claims), any sale proceeds will be committed to only partial satisfaction of the pledgee's claims (80 per cent for claims under loan agreements; 70 per cent for claims based on the obligations secured by the mortgage).

The sale of pledged property and extension of new financing to the borrower (pledgee) with subsequent pledge of the same property will not terminate or limit the initial pledgee's rights. The subsequent pledgee's claims will be satisfied out of the pledged property value only after claims of all preceding pledgees have been satisfied. A subsequent pledge is possible if it has not been prohibited by a preceding pledge agreement.

From 1 October 2016 the debtor must notify the creditors about foreclosure upon the debtor's real estate by including information in the URR on legal entities' activity that must contain the amount of the claim and its priority.

43 Cash management and reserves

Is it typical to require a cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

Banks and other financial institutions such as insurance companies and investment firms are required by Russian law to hold mandatory reserves (funds). The procedure for forming and using such reserves is set by the Central Bank of the Russian Federation.

Credit organisations establish the reserves to ensure their financial stability. The establishment of the reserve fund by the lenders that are not financial institutions is at the discretion of such lenders, since the law does not impose such a duty.

44 Credit enhancements

What other types of credit enhancements are common? What about forms of guarantee?

Russian civil law does not restrict the parties' choice of an obligation security method. The best regulated and most popular methods in Russia (other than pledge) include withholding of the debtor's property, surety, independent bank guarantee and deposit.

All obligation security methods provided by Russian law give rise to judicial and other legal remedies and are enforceable.

Parties to civil relations in Russia commonly use letters of credit in transactions settlements. Completion guarantees or recourse carveback guarantees are very rare in Russian practice. Advance payment guarantees are commonly used in construction agreements. As a general rule, the guarantor's obligation under a guarantee is limited to a certain amount of money that may indemnify against liquidated damages or the entire debt. 'Bad boy' guarantees are unknown in Russian law, because the lender has the right to recover the remaining amount out of the borrower's other property in event of the collateral's deficiency. It should be noted that such a rule may be changed or excluded by the parties, so it is possible to agree upon guarantee for full liability or damages in accordance with article 406.1 CC, but enforceability of similar provisions is uncertain.

45 Loan covenants

What covenants are commonly required by the lender in loan documents?

Covenants are a fairly new concept for Russian law, implemented from international practice. Russian law does not provide any compulsory requirements, while in practice the debt/EBITDA ratio is the most widely used covenant. It is also quite usual for banks to require that the debtor's entire revenues flow via the creditor bank.

There is no significant difference between covenants for freehold financing and ones for leasehold financing. The first type of covenant is related to the legal title to the real estate, whereby the vendor undertakes to enforce the contract of sale, for instance, sell the property free any encumbrances, ensure conveyance of the title and its registration, pay taxes, and refrain from conveyance until completion of the deal. The most popular covenants for leasehold financing include using leased property only for a specific purpose, complying with laws regulating maintenance and operation of the real estate, obtaining the lessor's consent prior to conducting non-removable improvements in relation to the property, insuring against loss and damage to the property or any third party, etc.

46 Financial covenants

What are typical financial covenants required by lenders?

Subject to the borrower's consent, lenders may incorporate any clauses in a loan agreement that are not contrary to Russian law. In practice, it is common to stipulate in such agreements requirements for the borrower to maintain certain financial indicators, limitations on certain types of expenses and undertakings of additional obligations, and to fix different loan interest rates depending on the loan term and amount, availability and form of security backing the borrower's obligations, the borrower's loan-to-asset ratio, or the borrower's general financial reporting indicators. Agreement may further impose requirements and conditions in relation to the debtor's property and obligations assessment reporting by the borrower.

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47 Secured moveable (personal) property

What are the requirements for creation and perfection of a security interest in moveable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

A pledge agreement has to be executed in writing, or where a pledge is intended to secure obligations under another agreement that is subject to notary certification, it must be also certified by a notary public. Non-compliance with the written or notarised form of a pledge agreement makes it void. The pledge may be recorded in a register of pledge notices. The rules on keeping the register are laid down in the legislation on notarisation. The information contained in this register is in the public domain so any person may request such information for purposes of checking the title to moveable property. The special procedure of recording is provided for the pledge of securities and the bank account pledge. As a general rule, the security interest will commence from the execution of the pledge agreement unless the agreement, the CC or other laws provide otherwise.

Russian law does not require a 'control' agreement for giving effect to security interests.

48 Single purpose entity (SPE)

Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

The concept of SPE has not been recognised, regulated or accepted in Russian law and practice.

Slovakia

Adrian Barger and Boris Stiffel

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General

1 Legal system

How would you explain your jurisdiction's legal system to an investor?

Slovakia has a civil law system. The fundamental pieces of Slovak private law are the 1964 Civil Code and the 1991 Commercial Code. The former codifies general private law principles, such as acquisition or transfer of ownership, liability for damages and contracts. The latter focuses on regulation of business-to-business relationships.

Although judicial precedent law is not absolutely binding, the legal certainty principle requires that identical cases are decided identically.

Oral contracts are enforceable. However, most contracts relating to real property are enforceable only upon execution of a written deed and its registration (perfection) in the land register (Cadastral Register). Amendments to a written contract relating to real property must also be in writing. In general, parol evidence is admissible unless it alters the unambiguous contents of a written contract.

Civil court proceedings are based on a partially adversarial trial system. Parties may provide evidence supporting their claims, however, a court will also seek evidence in order to reliably establish the facts. Applicants may apply for injunctive relief for various actions, such as prohibiting a property transfer or an eviction.

2 Land records

Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

Slovak real property law is based on the registration principle. Subject to certain exemptions, only an owner or holder of other property rights who is registered in the Cadastral Register is the rightful owner of real property or the holder of such property rights. Unregistered or unrecorded owners enjoy limited or no protection. Real property is registered in the Cadastral Register. The Cadastral Register is administered by district offices. All title transfer deeds and other legal deeds are deposited in the Cadastral Register. The Cadastral Register is not public and access is allowed only to certain public authorities and the respective owners of real property. For historical reasons, the Cadastral Register often contains only deeds from the early 1990s.

The Cadastral Register provides information on ownership, co-ownership and encumbrances. Registration of long-term land leases with a term over five years is optional. The Cadastral Register may also contain information on pending court and enforcement proceedings. Information extracts from the Cadastral Register are publicly available free of charge. Official extracts can be obtained for a fee at the relevant district office.

Individual ownership is evidenced on a deed of ownership. Subject to certain exemptions, every owner has one deed of ownership covering all of his or her real property owned individually and located in the respective cadastral area.

The principle of authenticity and publicity applies to information recorded in the Cadastral Register. Information in the Cadastral Register is considered reliable unless proven otherwise. Accordingly, a purchaser cannot claim that a property was purchased in good faith if a title defect could have been identified by a review of the relevant deed of ownership.

3 Registration and recording

What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

The same rules on registration of real property apply throughout all regions of Slovakia. Written contracts conveying title or establishing other property rights to real property must comply with the relevant codes and the 1995 Cadastral Act. In particular, contracts must be prepared in Slovak or Czech or officially translated. The signatures of sellers or obligors for pre-emption rights or easements must be officially verified unless the contract is in the form of a notarial deed or authorised by a Slovak licensed attorney. The district office reviews contracts' compliance with statutory requirements in the registration procedure.

The registration fee for a normal 30-day registration is €66. This fee is reduced by 50 per cent if it is applied for electronically. Parties may request an accelerated 15-day registration for an extra fee of €266.

The Cadastral Act does not specify which party is obliged to pay the fee. However, as a matter of practice, it is customary for the purchaser to pay.

Certain rights and obligations may be established through the passage of time (acquisition of title by usucaption (prescription), administrative or judicial decision regarding expropriation or judicial determination of title or sale at auction. These events or decisions are registered in the Cadastral Register (in this case, registration having only evidentiary effects) free of charge.

The real property transfer tax was abolished in 2004. There is no stamp duty. Owners of real property are subject to municipal real property tax depending on the type and location of the property.

4 Foreign owners and tenants

What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

Generally, foreign corporations and individuals can freely acquire or lease real property in Slovakia without further registration, permission or licence not otherwise required by Slovak residents.

The acquisition of farmland is regulated by the 2014 Acquisition of Farmland Act. The Act was adopted to address certain political concerns to protect domestic farmland ownership resulting from the expiration of the applicable transitional period agreed in the EU Accession Agreement. At present, the constitutionality of the Act is being reviewed by the Slovak Constitutional Court.

The 2014 Acquisition of Farmland Act prohibits acquisition of farmland by a foreign national if the acquirer's domestic laws prohibit acquisition of farmland by a Slovak national in the respective jurisdiction. This restriction on reciprocity, however, does not apply to EU and EEA member states and Switzerland. Another impediment to acquisition of farmland is the procedure obliging a seller to first offer the farmland to Slovak farmers. A foreign acquirer can only purchase the farmland after the official offer is made and declined or ignored. The seller must offer Slovak farmers the farmland on the same terms as the

foreign entities. The full tender procedure lasts over six months. These restrictions do not apply to farmland located in developed municipal areas or to farmland less than 2,000 square metres.

5 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

Foreign investors, after payment of all taxes and other levies, are free to repatriate profits from Slovakia. There are no exchange control limitations with respect to real property and all domestic and foreign investors (including investors from jurisdictions outside the EU) are treated equally. However, certain foreign exchange transactions must be notified to the National Bank of Slovakia.

6 Legal liability

What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

There are two types of liability in Slovakia. First, a party is liable for a breach of its statutory obligations, which includes also the general obligation to take preventive action to avoid damage. Under the rules of statutory liability, the owner of real property may be liable for any damage, including bodily injuries, caused to third parties on such owner's property if the owner violated its statutory duty of care and maintenance of the property. Second, a party is liable for breach of its contractual obligations.

Pursuant to case law, a person is liable for damages that are the direct and immediate consequence of such person's illegal conduct. Accordingly, courts are reluctant to acknowledge damage compensation to subsequent owners or tenants.

Real property owners must refrain from disturbing their neighbours by emissions, noise, vibrations or by otherwise impeding neighbour's ownership rights in a way exceeding normal conditions. Buildings must comply with technical requirements. The owner is liable for direct and immediate damages resulting from a breach of this duty.

In general, a polluter is liable for removal of the pollution or contaminants at his or her own expense.

7 Protection against liability

How can owners protect themselves from liability and what types of insurance can they obtain?

Various insurance instruments are available in Slovakia, including building insurance, environmental liability insurance and all-risk property insurance. Investors may protect themselves by incorporating a Slovak entity with limited liability. Legal and technical due diligence and properly drafted transaction documentation may also reduce the buyer's risk.

8 Choice of law

How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

Parties to a transaction may choose any governing law. However, rights to Slovak real property, including the form of contracts related to real property, must be governed by Slovak law. Ancillary provisions of the contract, such as payment conditions or other arrangements between the parties, may be governed by any law.

9 Jurisdiction

Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

Slovak civil courts have exclusive jurisdiction over in rem rights relating to Slovak real property. Only Slovak civil courts may hear real property lease disputes. Civil courts are organised into district courts (authorised to adjudicate almost all disputes), regional courts (generally serving as appellate courts) and the Supreme Court. A court must provide each party with an opportunity to represent its interests pursuant to the principle of effective judicial protection. Foreign service of process is governed by applicable international law and treaties.

Slovak law acknowledges the legal capacity of foreign persons. Foreign persons may use all legal remedies available to Slovak persons to enforce remedies in Slovakia.

10 Commercial versus residential property

How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

The regulation of ownership and financing does not differ between commercial and residential premises. Conversely, the regulation of residential property lease is more advantageous to tenants in that it stipulates a limited scope of a landlord's ability to terminate the lease and permits the tenant to terminate the lease for any reason upon notice.

11 Planning and land use

How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

Since real estate projects have a great impact on the public, they are rigorously regulated by the 1976 Construction Act, 2006 Act on Environmental Impact Assessment and 2013 Act on Integrated Prevention and Environmental Pollution Control. State authorities possess powers to advocate public interests, such as environment, hygiene, protection of historical monuments and public transport. Generally, a real estate project is subject to three principal permits: planning, building and occupancy.

Before any project development, investors should review the available municipal master plan and zone plan. Authorities will not issue required permits if the project does not comply with the relevant master or zone plan. Investors can also propose changes to the plans, however, the change requires the municipality's approval, which it may or may not grant at its discretion.

12 Government appropriation of real estate

Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

The competent Construction Office may expropriate real property wholly or partially only when such land is indispensable for the general interest. The Construction Office must provide a corresponding substitute property or payment of a market price compensation determined by an expert appraisal. Before expropriation, the Construction Office must attempt to negotiate a settlement with the owner.

13 Forfeiture

Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

The 2005 Criminal Code provides that a criminal court can seize real property acquired by individual or corporations illegally.

14 Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency system in your jurisdiction.

There are two insolvency tests in Slovakia. First, a debtor is insolvent (cash flow insolvency) if it is in delay for more than 30 days in repaying at least two monetary claims of at least two different creditors. Second, a debtor is insolvent (balance sheet insolvency) if it has at least two creditors and the value of its liabilities exceeds the value of its assets.

If the balance sheet insolvency test is met, the debtor's representatives must file for bankruptcy within a prescribed period. A creditor is entitled to file for debtor's bankruptcy if the cash flow insolvency test is met. The debtor may oppose creditor's petition and prove its solvency.

If the court declares bankruptcy over a debtor, all powers of representation of the debtor are transferred to the bankruptcy trustee appointed by the court. The trustee can, among other matters, terminate any real property lease agreement, including definite term agreements, concluded by the debtor in the position of a landlord or tenant, with two months' notice. Upon declaration of bankruptcy all lawsuits involving the debtor are suspended and cannot continue unless requested by the trustee. Similarly, upon declaration of bankruptcy, any enforcement proceedings involving the debtor's assets, including enforcement of security interests by lenders, are stayed.

An insolvent debtor may develop a restructuring plan and ask the court to permit creditor restructuring. Creditor restructuring involves an agreement with creditors on a pro rata settlement of their claims and restructuring of the debtor's business. If the debtor fulfils the restructuring plan, it may continue as going concern.

Investment vehicles

15 Investment entities

What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

The Slovak Commercial Code recognises the following corporate forms that are also available to foreign investors:

- general partnership;
- limited partnership;
- limited liability company;
- joint-stock company;
- simple joint-stock company; and
- cooperatives.

The corporate form limits the liability of partners of a limited liability company, stockholders of a joint-stock company, limited partners of a limited partnership and members of cooperatives. Partners in a general partnership and general partners in a limited partnership bear unlimited liability.

The most common forms of investment vehicles are limited liability companies or joint-stock companies.

Slovak law does not recognise real estate investment trusts. However, investors can invest through mutual funds maintained by a fund management company or through a collective investment company, including collective investment scheme with variable capital known as SICAV in western Europe (similar to an open-ended mutual fund in the US).

16 Foreign investors

What forms of entity do foreign investors customarily use in your jurisdiction?

Foreign investors typically prefer limited liability companies and joint–stock companies. However, investors from Austria and Germany often choose general or limited partnerships due to the favourable tax regime.

17 Organisational formalities

What are the organisational formalities for creating the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

Companies and partnerships must register in the Commercial Register. Entities established by several founders must submit a memorandum of association, while entities established by a sole founder must submit a founder's deed. Establishment of a joint-stock company requires the memorandum or deed to be in the form of a notarial deed. Mandatory registered capital of a joint-stock company is €25,000; a simple joint-stock company requires minimum of €1. A limited liability company must have a mandatory registered capital of €5,000.

The 2016 corporate income tax is 22 per cent. Income of partners in a general partnership and general partners in a limited partnership is taxed at the level of such partners, not at the partnership level.

There are no special taxes or reporting obligations imposed on foreign entities. Individuals planning to reside in and conduct business in Slovakia, except for EU nationals, need a residency permit.

Acquisitions and leases

18 Ownership and occupancy

Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

Slovak law recognises freehold as permanent unrestricted ownership and leasehold as tenancy for a definite or indefinite period of time, which may involve a right to derive profit from leased property. A creditor may request a charge over real property as security collateral. Note that Slovak law does not recognise the Roman principle 'superficies solo cedit'. Thus, it is possible for a building to have a different owner than the underlying land. Co-ownership of real property, especially of land, is common in Slovakia. A majority of co-owners controls co-owned property.

The individual owner of an apartment in a condominium is automatically a co-owner of all common parts and equipment of the condominium and land under the condominium, corresponding to the ratio of the floor area of the unit to the aggregate floor area of all premises in the condominium. The co-ownership share may be transferred only by simultaneous transfer of the respective apartment.

Slovak legislation recognises two types of easements: easement in rem and in personam. The former benefits all owners of a particular real property to which an easement is created and survives transfer of such real property. The latter is created solely for the benefit of a particular person.

Lease of residential premises is primarily regulated by the Civil Code. As mentioned in question 10, certain landlord rights are restricted. In 2014, the Short-Term Lease of Apartments Act slightly advanced the landlord's position, but only with regard to short- and mid-term residential leases.

Non-residential premises are premises that are designated for retail, office or industrial purposes. Non-residential lease agreements must be concluded in writing. A tenant is entitled to sublease the premises only with prior landlord's approval or specific authorisation in the lease agreement.

19 Pre-contract

Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

Slovak law recognises agreements on future transactions, which set the conditions under which the parties will be obligated to complete the transaction in the future. If the obliged party fails to proceed with the transaction, the other party may request a court to replace the demonstration of will of the obliged party. Slovak courts do not enforce non-bidding agreements, such as letters of intent or term sheets. Exceptionally, letters of intent contain binding provisions, for example, on exclusivity, preventing the seller to market the property to third parties, enforceable by the Slovak courts. However, it is customary to enter into non-binding instruments, such as letters of intent or term sheets, to set out the playing field in the initial stages of transactions.

20 Contract of sale

What are typical provisions in a contract of sale?

The contract of sale must be agreed in writing. The contract must include the following provisions:

- a description of the parties;
- a description of the transferred property – property type, cadastral area, building or plot identification number; and
- the price or the price calculation method.

Representations and warranties are not mandatory, although buyers are advised to include them. The seller usually makes representations and warranties regarding ownership, third-party claims, suitability of the property for agreed purpose and compliance with relevant building regulations. Larger real estate transactions usually include escrow payment mechanisms through notaries or banks.

21 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

Liabilities for environmental damages are generally tied to the polluter and the polluter's legal successors. In specific cases, when the polluter is unknown, the liability is transferred to the existing owner of the polluted property. If the polluter does not take preventive or clean-up action, the relevant authority may intervene and claim costs.

Investors tend to negotiate representations and warranties that the property is free of environmental burdens or that a facility is fully compliant with environmental legislation. A breach of contract triggers statutory or contractual sanction mechanisms, such as price adjustment, compensation for damage, contractual penalties or termination rights.

22 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

Sellers of property with existing leases usually provide representations concerning:

- the rent roll;
- the validity and enforceability of existing lease agreements or pre-lease agreements;
- the existence of cash deposits or bank guarantees;
- the existence of any defaults under the lease agreements;
- the existence of any pending or threatened terminations;
- litigation regarding the lease agreements; and
- compliance with tenant improvements.

Brokerage agreements are separate from the lease agreements and are not transferred together with the property unless the parties agree otherwise.

Between signing and closing, sellers usually covenant not to execute new leases or amend or terminate existing leases without the buyer's consent or not to carry out any unforeseen tenant improvements or other major investments without the buyer's consent.

Estoppel certificates from tenants are not common or required as a condition to the obligation of the buyer to close under a contract of sale.

23 Leases and real estate security instruments

Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

A lease is not subordinate to a security instrument. When a debtor fails to repay the debt and the debtor's property, which includes leases, is sold, the new owner becomes the landlord. The new landlord is not entitled to terminate existing lease agreements due to the change of ownership. On the other hand, the tenants are entitled to terminate the lease agreement, nonetheless, they must do so during the earliest statutory or contractual period designed for termination.

24 Delivery of security deposits

What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

Security deposits, either in the form of cash deposits or bank guarantees, are very common in Slovak commercial lease agreements. Usually, cash deposits are held in a bank account of the seller and are transferred to the buyer at closing. Tenant securities provided in the form of bank guarantees may be assigned from the seller to the buyer, however, the assignment usually requires the prior consent of the issuing bank.

Lease agreements typically contain periodic price revision clauses based on the agreed national or EU indices.

25 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain a zoning report or legal opinion regarding legal use and occupancy?

Title to real property does not transfer to a purchaser if the seller is not the rightful owner. Nevertheless, if the purchaser holds the land in good faith for more than 10 years, the purchaser acquires title by usucaption. Unless the usucaption defence is available, if a document is produced that challenges the title of the seller in the chain of title transfers, all subsequent transfers may be invalidated. The parties are then obliged to return what they received under the invalid contracts – the purchaser must return the property and the seller must return the price paid.

Therefore, it is crucial that investors perform thorough legal due diligence going back at least 10 years. Typically, legal due diligence is performed through checks of the documents deposited in the collection of deeds of the relevant Cadastral Register. Since the collection of deeds is not public, a purchaser needs the seller's involvement and

cooperation to access the documents. A zoning report or legal opinion is not usually prepared regarding legal use and occupancy.

Rights to real property are recorded in the Cadastral Register on a 'first in time, first in priority' basis. Notwithstanding this rule, secured creditors may change priority by written agreement registered in the Cadastral Register.

26 Structural and environmental reviews

Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

Engineering and environmental reviews are advisable, especially in high-value transactions. The reviews should establish any factual technical defects in the structures, non-compliance with the applicable legislation or technical norms, as well as any existing environmental burdens. It is customary to obtain standard representations regarding the technical condition of the transferred buildings as well as representations and indemnities regarding environmental matters. A separate zoning report or legal opinion is usually not provided. As mentioned in question 7, environmental liability insurance is available.

27 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

Lease agreements are usually reviewed by lawyers and other business consultants. It is prudent to analyse change of control, rent indexation and lease termination clauses, as well as pending or potential litigation.

Lease agreements survive the change in ownership of real property. However, tenants are entitled to terminate the lease under certain conditions (see question 23). In asset deals, property and facility management agreements do not survive a change of owner. Financing security instruments are independent from any lease and management agreements and subordination is not necessary.

28 Other agreements

What other agreements does a lawyer customarily review?

Lawyers usually review:

- agreements establishing pre-emption rights and mortgages;
- agreements providing access to real property if the property has no direct access to public infrastructure;
- easement agreements authorising a specific person (easement in personam) or any owner of a particular real property (easement in rem) to use utility connections or pipelines located on adjacent land;
- easement agreements authorising adjacent real property or their owners to passage through the sold property or to other usage of the property;
- utility supply agreements;
- property insurance agreements; and
- confirmations of payment of real property taxes.

29 Closing preparations

How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

Lawyers usually prepare a detailed closing checklist to verify whether all closing conditions and deliverables have been met. Typically, lawyers check whether all required corporate or pay-off certificates, extracts from the Commercial Register and deeds of ownership have been presented, whether all existing mortgages and other charges have been properly released and whether all the relevant agreements and project and design documentation have been delivered. Proration of costs and revenues from the property as of the closing date is also customary.

In an asset deal, contracts of sale are typically concluded at closing. Funding normally occurs simultaneously, but funds are often released to the seller only upon registration of the transfer in the Cadastral Register, which occurs up to one month after the closing.

30 Closing formalities

Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

The seller's signatures on the contract of sale must be officially verified and signatures of both parties must be on the same deed. Except for the verification of signatures by a notary, no government official is required to be present at signing or closing. Further, parties may sign the agreements separately.

31 Contract breach

What are the remedies for breach of a contract to sell or finance real estate?

A breach of contract entitles the injured party to terminate the contract, request compensation for damages or payment of contractual penalties. If a real property transfer contract is terminated after its registration in the Cadastral Register, the parties must enter into a reverse transfer agreement or seek a court decision determining the validity of the termination and the identification of the owner post-termination.

If the sold property has legal or factual defects, the purchaser may request a remedy of the defects or purchase price reduction, provided that the claim management procedure has been complied with.

32 Breach of lease terms

What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply?

Apart from the generally applicable remedies described in question 31, a landlord has statutory retention and pledge rights over tenants' assets located in the leased premises to secure claims for unpaid rent. However, such rights are rarely exercised in practice owing to a complicated legal procedure and low return. Tenants using premises after the termination of lease, irrespective of the method of termination, may be evicted through customary judicial proceedings. Tenants often claim damages from the landlord if the eviction is conducted without a proper judicial order. In certain cases, tenants can also seek preliminary injunctions to prohibit the landlord from evicting.

Financing

33 Secured lending

Discuss the types of real estate security instruments available to lenders in your jurisdiction.

Lenders in Slovakia usually require mortgages on the financed real property. A mortgage is created by a written contract and must be registered in the Cadastral Register. A mortgage is usually created over the land and all buildings developed on the land. Slovak law also permits the creation of mortgages over future property. For example, in residential development projects, a mortgage can be created over future apartments. The developer is obliged to transform the mortgage over the future apartments into a regular mortgage to finished apartments as soon as the building and the individual apartments are completed (this occurs prior to the transfer of title to the buyers).

In addition to mortgages, lenders may also require security over other classes of assets, such as shares in the borrower's project companies, borrower's bank accounts, receivables or stock. All of these security instruments are created through written contracts and registered in the relevant securities registers.

34 Leasehold financing

Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

Leasehold financing is not available in Slovakia.

Update and trends

Despite preparations for a complex regulatory overhaul of the real estate sector in 2015–2016, no final outcome has been reached. However, investors can choose from broader range of investment vehicle formats. The corporate framework was enhanced by a new form of 'simplified' joint-stock company and open-ended collective investment company scheme known in western Europe as SICAV (similar to an open-ended mutual fund in the US).

In 2015 and 2016 several notable retail and industrial property deals took place. Continuing demand for leasing of industrial space from the automotive sector and foreign investment funds have encouraged further development of the Slovak real estate market.

In addition, the Ministry of Finance aims to reduce corporate income tax from 22 to 21 per cent; however, the introduction of a new tax on dividends has also been reported.

35 Form of security

What is the method of creating and perfecting a security interest in real estate?

A mortgage is created on the basis of a written contract and perfected upon registration with the Cadastral Register. A mortgage over real property, created as part of an enterprise pledge, must be registered with the Central Notarial Pledge Register as well as in the Cadastral Register.

A mortgage contract must contain a specification of the secured claim, specification of the collateral, value of the secured claim or maximum principal amount that is being secured. The contract should state for how long the mortgage has been created. If no period is mentioned, the time period is indefinite.

36 Valuation

Are third-party real estate appraisals required by lenders for their underwriting of loans? Must appraisers have specific qualifications?

Banks usually require real property valuations to underwrite loans. Valuations are prepared either by in-house valuation departments of the banks or third-party professionals, which may, but need not, be registered with the relevant state authorities.

37 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

Lenders from another jurisdiction can provide loans secured by Slovak real property collateral under the same conditions and ramifications as Slovak lenders. This is, of course, subject to any banking or financial services regulations that may be applicable. Lien documents must be in writing, and in many cases a signature must be verified by a notary public. Documents signed and verified abroad require an apostille, unless the relevant international treaty provides otherwise.

38 Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

Interest rates are usually determined with reference to EURIBOR for loans denominated in euros. In some cases, fixed interest rate loans are available. A court may refuse to enforce what it determines to be an excessively high interest rate that is contrary to the fair business conduct principle.

39 Loan default and enforcement

How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

Secured creditors can enforce a mortgage or pledge when the underlying secured claim is not duly and timely paid. No separate judicial decision is required to commence the enforcement. The secured creditor may monetise the collateral in the agreed manner, without further assistance of any state authority. The most common form of enforcement is direct or auction sale. Note that an agreement made prior to the secured claim becoming due and payable, which would allow the pledgor to take ownership of the collateral on default, is void. Such an agreement may only be reached once there has been a default on the secured claim. Foreclosure usually takes two to six months depending on the liquidity of the collateral. On the other hand, unsecured creditors must bring a claim against a debtor to court before commencing enforcement of the claim.

40 Loan deficiency claims

Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

Lenders are entitled to recover money judgments against borrowers or guarantors for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure. There are no limitations on the amount or method of calculation of the deficiency. Generally, enforcement of a claim is subject to the applicable statute of limitation rules. The right to seek a deficiency judgment is statute-barred after four years from the day of breach of a contract.

41 Protection of collateral

What actions can a lender take to protect its collateral until it has possession of the property?

Slovak law recognises possessory and non-possessory pledges. The possessory pledge is usually applicable to moveable assets and provides the lender with higher security and comfort in the case of foreclosure. On the other hand, a possessory pledge is not practical from the perspective of operation of the debtor's business. In addition, if a lender possesses the pledged assets, it must protect the assets. The lender is liable for any damage or loss of the assets. The lender may not use the pledged assets without the debtor's consent. Consequently, a majority of pledges and mortgages are non-possessory. If a lender initiates enforcement of the non-possessory pledge or mortgage, the debtor must hand over the collateral to the lender upon request. If a loan is secured by a pledge over lease receivables, the debtor must notify the tenants of the commencement of the pledge enforcement and direct them to pay the rent to a designated bank account of the lender. If the debtor fails to notify the tenants, the lender is entitled to notify them directly.

42 Recourse

May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

A provision allowing recourse to other assets of the borrower where the value of the collateral is lower than the secured claim is generally admissible under Slovak law. However, the enforcement of such

recourse provision would differ from the enforcement of the collateral. In a bankruptcy situation, a person bringing a recourse claim would be treated as an unsecured creditor ranking pari passu with other unsecured creditors.

43 Cash management and reserves

Is it typical to require a cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

Lenders usually require that all cash traffic of the borrower is directed through bank accounts opened with that lender or to special bank accounts controlled by the lender to ensure priority of payments. Similarly, lenders often implement various cash-trap or cash-sweep mechanisms linked to specific financial covenants or other triggers.

44 Credit enhancements

What other types of credit enhancements are common? What about forms of guarantee?

Various types of performance or retention bonds are customary in Slovak real estate development. The rights of the employer under these bonds are often assigned to the financing bank, or a pledge over the receivables under such bonds may be created in favour of the financing bank. The bonds are usually provided as bank guarantees or holdbacks.

45 Loan covenants

What covenants are commonly required by the lender in loan documents?

Commercial real property loan agreements usually contain standard general, information, negative and property covenants. The covenants may differ depending on the asset classes (retail, office, hotel or industrial).

46 Financial covenants

What are typical financial covenants required by lenders?

Financial covenants found in Slovak real property loan agreements are not dissimilar from covenants elsewhere in the central and eastern European region. Such covenants typically include a LTV (loan-to-value), an ICR (interest cover ratio) or a DSCR (debt service cover ratio) covenant. The covenants are periodically reviewed and usually require ongoing appraisals during the term of the loan.

47 Secured moveable (personal) property

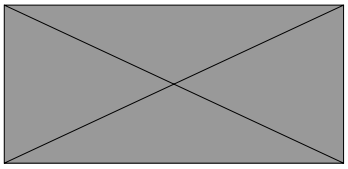
What are the requirements for creation and perfection of a security interest in moveable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

The creation and perfection of a security interest in moveable property or intangibles is very similar to the process described in questions 2 and 35. A written agreement must be submitted to the Central Notarial Pledge Register in the case of pledges over moveables and the Industrial Property Office in the case of pledge over intangibles. A pledge over moveable property may be created as possessory pledge and, in such a case, no written agreement and registration is required. The pledgor must deliver the collateral to the pledgee or a designated third party as a condition for the creation of the pledge. Laws on enforcement of judgments restrict enforcement of a security interest in specific moveables such as household items or medical aid possessed by individuals.

48 Single purpose entity (SPE)

Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

Slovak law does not require the creation of an SPE for each loan transaction. Lenders usually require that each borrower be an SPE in larger project financing deals. In such case, general corporate law rules apply to each SPE.



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General

1 Legal system

How would you explain your jurisdiction's legal system to an investor?

Sweden has a civil law system. However, case law (primarily from the Supreme Court and the courts of appeal) and preparatory work play an important role in interpreting general legal statutes as well as areas not explicitly covered by legislation.

Sweden's legal system with regard to real property is in general regarded as highly developed and well-functioning with good predictability, reliability and security for parties. The main source of law is the Land Code, which governs all essential aspects of private real property law, such as what constitutes real property, what constitutes fixtures to real property, how transfers of real property are made, how to obtain title, mortgaging, easements, usufructs and leases and the registration of rights.

All Swedish land is divided into real property units that are individually identified by a name and a code. Apart from the land itself a property unit comprises buildings and fixtures.

Regarding legal proceedings in court, the Code of Judicial Procedure states, as a principal rule, a duty for the courts to take all evidence into account when determining a case. The rule includes the right for a party to freely submit evidence and the right of the court to value any evidence submitted to it.

Two forms of interim remedies are available in a Swedish court proceeding to a party who wishes, for example, to prevent an action: on the one hand, the arrest of assets, and on the other, other injunctions, such as restraining orders preventing the other party from using a trade name under dispute.

The ruling freedom of contract principle provides that oral agreements are generally considered equally valid and enforceable as written contracts unless otherwise provided in the law. For example, transfers of real property require a written form. Parol evidence is admissible in Swedish courts.

2 Land records

Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

All real property is registered in Sweden in a public land register held by the Swedish mapping, cadastral and land registration authority (the Registration Authority). The Land Register shows who owns the title to land of a specific property and details the means by which this party became owner of the real estate (including date of purchase and purchase amount). Furthermore, the Land Register contains information about mortgages and mortgage deeds, leases, easements, usufructs and other contractual encumbrances. The cadastral data in the Land Register shows decisions on property formation and planning as well as geographical information such as size and position coordinates. The taxation value for land and buildings is also shown.

Registration of title is not a legal requirement in the transfer of ownership, which means that the person registered as title-holder may not necessarily be the legal owner of the real estate. Therefore, prior to buying property it is common practice to ask the seller to guarantee in writing that he or she is in fact the legal owner of the property. A buyer is required to register for title within three months of completing a transfer of real property. Failure to register within the stipulated time will not, however, make the transfer invalid.

3 Registration and recording

What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

Transfers of real property must be in written form and must contain a declaration of transfer, the purchase price and the identity of the parties and the property being transferred. Furthermore, the seller's signature shall be witnessed by two persons.

Typically, the transfer is documented in two separate agreements: a sale and purchase agreement (SPA), containing the terms and conditions of the transfer; and a bill of sale, entered into in connection with closing, the latter merely fulfilling the formal requirements of the law. The bill of sale is submitted to the Registration Authority for registration of title. It is important to note that if there are any conditions of the transfer to the effect that the transfer shall be null and void if not fulfilled, these must be repeated in the bill of sale in order to be valid. It should further be noted that a direct transfer of real property (ie, one that is not made through a special purpose vehicle (SPV)) can only be made conditional for a maximum period of two years. A buyer is obliged to register for title within three months of completing a transfer of real property. Failure to register within the stipulated time will not, however, make the transfer invalid.

The transfer of property triggers stamp duty (transfer tax) at a rate of 4.25 per cent for legal persons (with some exceptions) and 1.5 per cent for private persons. There are a few exceptions to the obligation to pay stamp duty of which the only one with practical effect is the 'transport purchase'; if a purchased property is sold on within three months on the same terms and at the same price as the first transfer, stamp duty will only be payable on the latter transfer. Furthermore, the parties to transfers made within a company group may be granted postponement of the duty to pay the stamp duty until the real property in question, directly or indirectly, is sold or otherwise transferred to a third party outside the company group in question. Unless otherwise agreed between the parties, the law stipulates joint and several liability for the seller and the purchaser to pay the stamp duty. In practice the purchaser will usually pay the stamp duty.

A way of minimising taxes in connection with a transfer of property is to use special purpose companies as transfer vehicles (SPVs). The real property is sold to a subsidiary of the property owner (the SPV, which is usually a newly formed limited liability company) at a price that corresponds to its tax-residual value or value for taxation purposes (which are usually significantly lower than the market value). Then the shares in the SPV are sold to the third-party purchaser at a price corresponding to the difference between the property's market value and its book value plus the equity of the SPV, in some cases with additional adjustments, such as adjustments for deferred taxes. The latter transfer (ie, the transfer of the shares in the SPV) is normally exempt from capital gains tax and the stamp duty payable is reduced since it will be based on the price paid by the subsidiary for the real property (or the value for taxation purposes if higher) instead of being based on the real property's market value. Once the property is owned by the SPV, subsequent

transfers of the shares in the SPV will not trigger stamp duty. Stamp duty can furthermore be minimised or even avoided if a real property is transferred to a new owner through cadastral procedures such as property amalgamation (ie, where a real property is merged with another, forming one new real property).

4 Foreign owners and tenants

What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

There are no restrictions for non-resident entities and individuals to register title to, own or lease real property in Sweden.

5 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

There are no exchange control issues for non-residents investing in properties in Sweden.

6 Legal liability

What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

Environmental liability, stipulated in the Environmental Code, is primarily based upon the 'polluter pays' principle, that is, the operator who has caused or contributed to a contamination is liable to investigate and remediate the contaminated area. The liability for remediation of contaminated areas is not limited in time. An owner of real property may under certain circumstances be deemed to be the operator even though he or she is not conducting any business on the property.

Furthermore, there are provisions for subsidiary liability of owners of real property in the event that the liable operator cannot be found or is not able to undertake necessary remedial measures. An owner of real property who knew of or should have discovered a contamination at the time of acquisition of the real property in question (provided that the acquisition was effected on or after 1 January 1999) may thus be liable for remedying the contamination.

Aside from environmental liability, Swedish law places liability on an owner of real property with the aim of preventing accidents. A property owner is obligated to take precautionary measures to prevent accidents on the real property and generally to look after and take care of the real property. Setting aside one's obligations as a real property owner may result in publicly regulated sanctions, such as the property being placed under receivership, administrative fees and criminal liability, as well as liability to pay damages to private persons in the event of damage occurring as a consequence of a real property owner's actions or negligence.

Finally, there is a general liability for negligence and wilful misconduct.

7 Protection against liability

How can owners protect themselves from liability and what types of insurance can they obtain?

There are insurance policies available to real property owners that provide cover for liability to pay damages as a consequence of sudden and unforeseen environmental damage to persons or third-party property owners. There are furthermore insurance policies that provide cover for clean-up in the event of sudden and unforeseen leakages of oil and other liquids.

When facing a transaction, a seller can take out insurance that covers historical environmental risks on the real property. There are, in addition, types of insurance that provide cover for third-party liability in general.

A way of shielding yourself from third-party claims in relation to a real property is to place the real property in a limited liability company (ie, owning the real property indirectly). It should, however, be noted that on rare occasions the corporate veil has been pierced in Sweden, thus making the owners liable for the limited liability company's debts and obligations.

8 Choice of law

How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

As a member of the European Union, Sweden is a party to the Rome I Regulation (Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations), which states two main principles for the choice of law in contractual relations.

First, there is the principle that a contract between two parties shall be governed by the law chosen by the parties. Second, in cases where an applicable law has not been agreed between the parties, the agreement shall be governed by the law of the country with which it is most closely connected. For real property the concluded agreement is assumed to be most closely connected to either the country where the property is situated or the country where the contract was concluded. If an agreement comprises real properties situated in two jurisdictions, and no choice of law has been made, the second principle will be of importance in deciding upon applicable law, that is, to which country the agreement as a whole is most closely connected.

Notwithstanding the above (whether the parties have made a choice of law), the contract, the subject matter of which is a right in real property or a right to use real property, shall be subject to the mandatory requirements of form of the law of the country where the property is situated (lex rei sitae), if by that law such requirements are imposed.

9 Jurisdiction

Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

When a dispute concerns a right in real property or a right to use real property, the dispute shall as a rule be settled by the district court in the district where the real property is situated.

There are land and environmental courts that handle cases related to property parcelling, expropriation, site leaseholds (including cases related to the level of the rent), planning and building permits and environmental issues under the Environmental Code, etc. Furthermore, there are tenancy tribunals that handle issues related to tenancy, such as disputes between landlords and tenants, approvals of certain terms of lease contracts, etc.

A party does not have to be qualified to do business in Sweden in order to enforce remedies.

10 Commercial versus residential property

How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

In general, there is no difference between commercial and residential properties as regards real estate ownership and financing, or the enforcement of those interests in real estate.

As regards tenancy, the Land Code provides mandatory regulation in order to safeguard commercial as well as residential tenants. Laws concerning leases that provide the tenant with a dwelling offer detailed and far-reaching protection for the tenant.

11 Planning and land use

How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

The main laws governing planning and land use are, aside from the Land Code, the Planning and Building Act, which regulates building and planning of land and water, and the Environmental Code, which regulates the usage of land, water and natural interests.

Under the Planning and Building Act, all municipalities are obliged to produce a comprehensive plan that provides guidance for decisions concerning the use of land and water areas and on how it should be developed and preserved. Furthermore, it provides guidance for further planning and permit applications. The comprehensive plan is not binding on the authorities and individuals.

The municipalities are also responsible for producing a legally binding detailed plan when development is anticipated, which specifies, inter alia, intended land uses, building lots, design, materials, floor areas, landscaping, parking, conservation and the implementation time.

Legal protection exists for buildings of certain cultural and historical interest through the Cultural Environment Act and the Planning and Building Act.

12 Government appropriation of real estate

Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

Compulsory purchases (expropriation) of real estate and certain other types of tenure can be carried out by the authorities to fulfil certain important public interests, which are expressly listed in the Expropriation Act. The purchase price is the market value and the property owner sometimes receives damages for financial losses caused by the purchase.

There is also an option for the authorities to grant perpetual rights in real estate for public roads and for wiring and pipes. The process for acquiring these rights is similar to the process of expropriation.

13 Forfeiture

Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

Real estate can be seized and forfeited if it has been obtained as a result of an illegal act or with proceeds derived from an illegal act.

14 Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency system in your jurisdiction.

The principal rule in Swedish bankruptcy legislation is that any claim will entitle a creditor to file a petition for bankruptcy against an insolvent debtor. It is not necessary for a claim to have become due for payment, nor for the applicant to have a writ of execution. The creditor is, however, under a duty to prove his or her claim. In certain cases there are statutory rules for presumption of insolvency.

If a debtor is declared bankrupt, the district court must appoint one or more trustees in the bankruptcy as soon as possible. The appointment is valid for the whole duration of the bankruptcy proceeding. The trustee will immediately assume full authority over the debtor's property (the bankruptcy estate).

A bankruptcy estate comprises all property belonging to the debtor at the time of declaration of bankruptcy or accruing to it during the bankruptcy proceedings, and such other property that is capable of being seized. The Rights of Priority Act ranks creditors' claims in the event of bankruptcy as follows.

Creditors in possession of pledged assets (ie, mortgage certificates in a real property) securing their respective claims have a special preferential right to the pledged assets in question. Other creditors with a general preferential right will obtain payment from the assets of the bankruptcy estate in a certain order. Among these are creditors who are in possession of floating charges. A floating charge represents a security interest in the changing assets of a business enterprise. The value of a floating charge is 55 per cent of the remaining assets of the bankruptcy estate, that is, assets that are not encumbered through pledges or otherwise have a better priority under the general preferential rights. Any other creditors will have a non-preferential right to the assets of the bankruptcy estate. These creditors' claims are only paid after all claims with preferential rights have been settled, which often means that these creditors will receive little or no payment in the event of bankruptcy.

Investment vehicles

15 Investment entities

What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

There are a number of entities available to an investor investing in Sweden. The most commonly used in real property investment structures are limited liability companies and limited partnerships or a combination thereof.

Pass-through entities for tax purposes exist in the form of general and limited partnerships. Such entities are not themselves liable to pay income taxes, but are liable to pay other taxes such as property tax.

Entities that best shield ultimate owners from liability are limited liability companies. The liability of the shareholders is normally limited to the share capital. Only in very few cases has the corporate veil been pierced in Sweden subjecting the owners to liability for a limited liability company's debts and obligations.

16 Foreign investors

What forms of entity do foreign investors customarily use in your jurisdiction?

For the reasons stated above as well as for tax reasons, it is at present customary for investors to use limited liability companies when investing in real property.

17 Organisational formalities

What are the organisational formalities for creating the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

Creating a Swedish limited liability company is a relatively straightforward and quick process. A limited liability company is identified by a registration number given to it by the Companies Registrations Office. Limited liability companies are represented by a board of directors and sometimes a managing director. At least half of the members of the board of directors and the managing director must be resident within the European Economic Area. If none of the members of the board, or the managing director, is resident in Sweden, the company must have an authorised representative, resident in Sweden, to receive service of process on behalf of the company.

A limited liability company must submit an annual report consisting of a profit and loss account, a balance sheet, notes on the accounts and a directors' report for each financial year. The annual report must be sent to the Companies Registration Office not later than seven months after the end of the financial year or the company will be charged a penalty for delay. Further delays will result in additional penalties and may eventually result in the company's dissolution and the directors becoming personally liable.

Even though creating a new limited liability company is relatively easy and quick, the most common and even faster way of setting up a company is by purchasing an existing off-the-shelf company.

A Swedish limited liability company is subject to a statutory corporate tax rate of 22 per cent, which is a flat rate on all taxable income and gains. Branch income is taxed at the same tax rate and general

corporate tax rules apply for any branch offices set up in Sweden. From a tax viewpoint, the most advantageous type of entity for a foreign investor to use will depend on the specific investment situation at hand.

Acquisitions and leases

18 Ownership and occupancy

Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

The most common way to hold a property is through a freehold (permanent unrestricted ownership), which includes the right to own, occupy, use, and dispose of land and associated buildings owned by the landowner. A freehold also includes ownership of the earth below and the air above although these rights are restricted to some degree.

Other forms of occupancy include site leaseholds, a right to use real property belonging to the government or municipalities for longer periods of time for an annual fee; leases, an exclusive right to use a building or part of a building in return for rent; and land leases, an exclusive right to use land for a definite period of time in exchange for a fee. Site leaseholds are generally treated in the same way as freeholds when it comes to transfers and mortgages and are generally considered to provide as good a form of security as a freehold.

Easements are common and can either be created by way of mutual agreement between a servient estate and a dominant estate, or by the Registration Authority as a part of a reallotment procedure (official easements). Contractual easements are regulated in the Land Code and are only valid in written form. It is not necessary to register contractual easements, though it is common. Official easements are more stable than contractual ones as dissolution of the easement must be decided by the Registration Authority and not by the parties themselves.

Housing cooperatives are common, where the land and building is owned by the cooperative and where each member of the cooperative owns a share granting a right to occupy a specific housing unit in the building. This form of tenant ownership is regulated by the Tenant Ownership Act. Shares in housing cooperatives are bought and sold on the housing market in the same way as ordinary titles of ownership.

19 Pre-contract

Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

Pre-contractual arrangements include confidentiality agreements, covering negotiations and information disclosed during due diligence investigations, and letters of intent for the purpose of, for example, granting a buyer exclusivity (ie, the seller taking the property off the market for a specified period of time in order to allow a specific purchaser to conduct a due diligence and negotiate a final sale and purchase agreement), agreeing on a framework for negotiations and procedures related to the due diligence.

The parties are free to agree to what extent a letter of intent shall be binding. Usually a provision will be included that explicitly states which parts are legally binding between the parties and which merely state the parties' respective intentions. Binding provisions usually include exclusivity, confidentiality and procedures for due diligence, while any provisions containing material terms to be included in a future sale and purchase agreement are usually stated as not binding or as subject to due diligence.

Letters of intent are sometimes labelled memorandums of understanding or terms sheets. These documents generally contain similar provisions, and Swedish law does not differentiate based on the labelling of the document.

20 Contract of sale

What are typical provisions in a contract of sale?

SPAs regarding real property and real property-owning companies are quite standardised on the Swedish market. When transferring real property directly there are formal requirements on the contract, as stated above. The transfer of shares on the other hand can, at least in theory, be executed by oral agreement.

A typical SPA will comprise a declaration of conveyance of the object of transfer (whether it is a real property or the shares in a property holding company); the purchase price mechanism; closing deliveries (see question 29); representations and warranties; limitations of liability; specific indemnities; undertakings in relation to ongoing projects; management of the property or company between signing and closing; and a set of boilerplate clauses regarding confidentiality, amendments, governing law and dispute resolution, etc.

Typical warranties that may be given by a seller for the sale of real property relate to the following:

- capacity of the seller;
- title and ownership of the property;
- encumbrances;
- compliance with relevant zoning plans and building permits;
- injunctions or orders from courts and authorities;
- legally prescribed inspections;
- public fees;
- leases;
- environmental issues; and
- the accuracy of information disclosed to the buyer during the due diligence process.

When a sale concerns shares in a property holding company, the warranties may also comprise the following issues:

- ownership of the shares in the company;
- encumbrances as regards the shares;
- the operations of the company;
- accuracy of registered information relating to the company;
- ongoing or pending disputes or litigation;
- accounts; and
- taxes and public fees.

21 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

When transferring real property a seller may give the purchaser certain environmental warranties. The duration for such warranties varies but will in general survive closing for a period of three to five years.

Typical environmental warranties include:

- the existence of necessary permits for the business conducted on the real property;
- that the business conducted will not give rise to any injunction or liability according to applicable environmental legislation;
- that the real property is not contaminated;
- that the real property does not contain any waste stored in depositories; and
- that there are no building materials on the property that will entail extraordinary costly decontamination actions when construction works are done on the property (typically this refers to asbestos).

The typical remedy in an SPA will be a reduction of the purchase price or damages. On rare occasions, the parties may agree to include a right for the purchaser to terminate the contract in cases of material breach. Warranties will usually survive closing for periods varying between six to 18 months. Normally, the parties will agree to exclude statutory remedies, which would otherwise be available to the buyer.

22 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

Typical representations and warranties made by sellers of real property regarding leases are statements to the fact that the existing lease agreements (as disclosed to the purchaser) are valid and binding and contain all terms and conditions related thereto and that there are no outstanding undertakings in relation to the tenants except as disclosed to the purchasers. Representations and warranties related to leases will typically survive completion of the transfer by between six and 24 months.

Typical covenants made by sellers of real property concerning leases between contract date and closing date include undertakings not to execute new leases or amend existing leases without the purchaser's consent and otherwise continue to manage the property in the same manner and to the same extent as has been done prior to signing of the transfer agreement.

A lease agreement will, as a general rule, survive a transfer of a real property and be valid and enforceable both by the tenant and the new landlord. Thus there is no need for a buyer to require estoppel certificates from tenants.

23 Leases and real estate security instruments

Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

The relationship between usufructs and mortgages is, as a general rule, decided by looking at when in time the usufruct and the mortgage were registered in the Land Register. A usufruct, which has been registered prior to a particular mortgage, will be protected in the case of a sale of property forced by a lender in possession of the mortgage in question.

Commercial leases are rarely registered in the Land Register; in spite hereof they will be protected in connection with a forced sale provided that they do not cause considerable damage to creditors with a superior right in the property. In other words, leases entered into on commercial terms and on an arm's-length basis will in practice, as a general rule, survive a forced sale of a property.

Subordination and non-disturbance agreements are not common in Sweden, though there is a possibility for the tenant and the landlord, subject to approval by the tenancy tribunal, to agree on the tenant's waiver of its indirect right of tenure (see question 27), thus making the leased premises available to the landlord upon the end of a lease term.

24 Delivery of security deposits

What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

Securities for the tenant's obligations under a lease are quite common and are usually submitted in the form of cash deposits or bank guarantees. When transferring a property the cash deposit will be transferred to the buyer at completion. If the security is in the form of a bank guarantee, the bank in question needs to be informed and confirm the transfer of the rights of the seller under the bank guarantee to the purchaser.

During a lease term, rent levels for commercial premises may, provided that the lease term is longer than three years, be based on, inter alia, changes in an index, for example the Swedish consumer price index. At the end of a lease term, renegotiations of rent levels may take place provided either party has served the other party with a notice of termination containing a demand for rent review.

25 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain a zoning report or legal opinion regarding legal use and occupancy?

The Land Register is available online or through contacts with the land registration authorities. The Swedish government guarantees the accuracy of the Land Register; there is therefore no need for title insurance, and consequently it does not exist in Sweden.

The time of registration will decide the rank of the various interests in the estate. An encumbrance confers priority in relation to another encumbrance in the chronological order in which the encumbrances are applied for. An encumbrance applied for on the same title registration day confers equal title. In relation to a right of use, an easement or a right to electrical power, an encumbrance confers priority if it is applied for before title registration of the right is applied for. Title registration of a right of use, easement or right to electrical power confers priority over an encumbrance applied for on the same title registration day.

Due diligence reviews will normally comprise zoning plans for the area where the property is situated; zoning reports or legal opinions related to such issues are not customary.

26 Structural and environmental reviews

Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

It is customary for buyers, as part of their due diligence review, to arrange both engineering and environmental reviews. Representations as to a property's physical status are very rare; however, environmental representations and warranties do occur (see question 21). In the event of, for example, discoveries during the due diligence of physical defects in buildings, indemnities or undertakings by the seller to remedy such defects prior to or during a limited time after closing may occur.

Regarding environmental insurance, see question 7.

27 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

Depending on the buyer's knowledge and the complexity of the lease agreements, lawyers may be assigned to review leases as part of the legal due diligence review.

For commercial leases the terms of the agreements are, with some important exceptions, freely negotiable between the parties. There are a few mandatory rules in favour of the tenant that an investor should take into account, as follows:

- the rent must (with the exception of at-cost rent for media consumption and rent based on the tenants' turnover) be set to a fixed amount if the lease term is shorter than three years;
- tenants have an indirect right of tenure, which provides a right to compensation for the loss of the lease if the landlord at the end of a lease term either terminates the lease with the purpose of vacating the leased premises or demands conditions for the lease to continue that are not considered to be in line with the market, and the tenant decides to leave the premises as a consequence thereof;
- the grounds for forfeiture of a commercial lease are fixed by law; and
- the tenant has under certain circumstances a right to transfer the lease.

It is not common practice for lenders to require management agreements to be subordinate to financing security agreements.

28 Other agreements

What other agreements does a lawyer customarily review?

Other documents covered by a legal due diligence may comprise corporate documentation (in the case of a transfer of shares) relating to the property-owning company, service contracts, easements, municipal plans, public permits, agreements related to ongoing works and other agreements of a significant nature. Also in the case of a transfer of a site leasehold the lease agreement with the municipality or the state will be reviewed.

29 Closing preparations

How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

As part of ensuring that all documentation and deliverables are in place in order for closing to be effected, lawyers will normally produce an agenda for the closing, wherein the actions to be taken in order to effect closing are listed. Typical items in a closing agenda will include:

- verification that any conditions precedent have been fulfilled or waived;
- verification of proper authority of the parties' respective representatives;
- the deliverables (including mortgage certificates or release forms issued by the mortgage holding banks, original copies of the lease agreements and other agreements and documents of relevance, deposits made by tenants, etc);
- payments to be made;
- prorating of income and costs as per the closing date; and
- assignment of any relevant agreements, etc.

Furthermore, if the object of transfer is a property holding company the agenda will include, among other things, deliverables in the form of share certificates and share registers, the replacement of directors and officers in the target company and delivery of a general power of attorney for the purpose of enabling the purchaser to act on behalf of the company until the new directors and officers have been registered with the Companies Registration Office.

Normally, there is a time period between signing and closing where the seller agrees to refrain from taking actions (of material importance) that may affect the property, unless the buyer has consented to such actions.

30 Closing formalities

Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

Closing does not require all parties to be present at the same time and is usually done by the lawyers representing the parties, or a broker. There is no need for any agency or representative of the government or specially licensed agent to be present to approve or verify the transaction.

31 Contract breach

What are the remedies for breach of a contract to sell or finance real estate?

The Land Code contains a large number of rules concerning the rights and obligations of the seller and the purchaser. These rules are non-mandatory and therefore, may be regarded as a form of standard conditions for the sale or finance of real property. Further, the rules concerning remedies for defects of the real estate are based on the principle that the seller is responsible for the property's compliance with what follows from the agreement. Hence, the rules are often modified in the sale and purchase agreement between the parties. If the real estate is defective, the purchaser may revoke the agreement, reduce the purchase price or demand damages.

If the purchaser breaches the duty to pay the purchase price, which is due, or is unable to deliver the real estate, the seller may, inter alia, demand damages for the damage caused thereby and may also revoke the contract under certain circumstances. However, as stated above, the parties usually agree upon an extensive exclusion of liability in the sale and purchase agreement regarding real estate. Finance of real estate is mostly regulated in the loan agreement between the lender and the borrower.

32 Breach of lease terms

What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply?

There are special real estate rules in place for breach of lease terms. In commercial lease agreements regarding non-residential premises, non-mandatory specific real estate rules regarding breach of lease terms are often waived. Depending on the category of breach, a tenant will usually have the option of claiming a reduction of the rent and, in case of defects, demand that the defect should be repaired or claim damages for costs incurred to remedy the defect.

A landlord usually only has the option of claiming damages in the case of a tenant's breach but can also terminate the lease prematurely if there are grounds for forfeiture of the lease. The statutory grounds for forfeiture are where the tenant (or, where appropriate, anyone who the tenant is responsible for), inter alia, defaults in paying rent, does not observe tidiness and good order in using the premises or uses the leased premises for purposes other than those stated in the lease agreement.

Financing

33 Secured lending

Discuss the types of real estate security instruments available to lenders in your jurisdiction.

In relation to real estate financing, the most common and important security instrument available to lenders is a pledge over existing or new mortgages over real estate, as it offers strong protection against third parties.

For more information on security instruments, see question 35.

34 Leasehold financing

Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

Financing is available for ground leases. As regards security instruments available and in contrast to real estate, ground leases cannot be pledged, which means that loans need to be secured by other assets of a borrower or other types of security instruments.

35 Form of security

What is the method of creating and perfecting a security interest in real estate?

In order to perfect any type of pledge, the pledgee and the pledgor need to enter into a pledge agreement whereby the asset in question is pledged as security for a particular claim from the lender.

In order to pledge real property, the holder of the legal title to the real property must take out mortgages on the real property. When taking out a mortgage a stamp duty of 2 per cent on the face value of the mortgage certificate is charged. Mortgages can be made in any amount. A mortgage is evidenced by a mortgage certificate, which can be in either physical or electronic form. A mortgage certificate is perpetual and can be used and reused without incurring any stamp duty or transaction costs. In order to perfect a pledge in a real property the pledgee must take possession of the mortgage certificate, or in the case of electronic mortgage certificates be registered as possessor in the Land Register.

In cases where real property is owned by a Swedish limited company a lender may furthermore demand security in the shares of such company. The method for perfecting a pledge in unlisted shares is for the holder of the shares to transfer the share certificates representing the shares in bearer form and then physically hand them over to the pledgee. In order to further strengthen the pledge, the parties can

Update and trends

Although banks became more restrictive in their lending after the 2008 financial crisis, we have observed that transaction volumes have increased since the immediate aftermath of the crisis. Transaction volumes during the first half of 2016 have been very high. A contributing factor has been the historically low Swedish interest rates.

An increased demand for housing in Sweden has created new trends in the real estate market, where a large number of new operators have joined, and there are even some that have listed themselves on the stock exchange. These companies, whose primary focus is to create new housing through the conversion of existing buildings, operate primarily in the Stockholm region along with other emerging regions. Other companies are pure project companies that acquire undeveloped land, produce new zoning plans and then develop new housing. Such companies are particularly dependent upon finding alternative funding opportunities outside of the banks.

In parallel with the above, Swedish public pension funds have increased their activity in the property market through direct and indirect investment in real estate, which has created another large presence in the market.

A continuous trend is that big capital tends to target real estate indirectly, through investment funds and financial products, instead of direct investments in real estate or property-owning companies.

The most popular financial products, as an alternative to bank financing, are preferred shares and subordinated bonds where the yield and interest rate have been relatively high and banks have for all purposes perceived these types of instrument as equity.

ensure that the board of directors of the company who issued the shares in question makes a note of the pledge in the company's share ledger. In cases where the company's shares are listed on a stock exchange (and in certain other cases when the share ledger is administered by an external party) no share certificates are issued and a pledge of such shares is instead perfected by way of registration.

Another common form of lien is the pledge of the balance in a bank account. Such pledges are perfected by notifying the relevant bank of the pledge, and depriving the pledgor of its ability to dispose of the account in question without the pledgee's consent.

Pledges over contractual rights, such as receivables, are perfected by notification to the other party (the debtor) of the pledge. Furthermore, it is necessary to deprive the pledgor of control over the pledged right, that is, the right to receive payments under the agreement in question. This may be done by instructing the debtor to a new account that the pledgor does not control.

Finally, it should be noted that the Insurance Agreement Act gives a mandatory right for creditors with collateral in real property, that is, creditors in possession of pledged mortgage certificates, to receive insurance proceeds corresponding to the claim which is secured by the collateral, even when the claim is not due for payment.

36 Valuation

Are third-party real estate appraisals required by lenders for their underwriting of loans? Must appraisers have specific qualifications?

Third-party real estate appraisals are often used in the valuation of property and lenders generally demand periodical valuations of pledged collateral. Valuation is commonly made by authorised real estate appraisers.

37 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

There are no restrictions on lenders from other jurisdictions when it comes to securing a loan by collateral in Sweden.

For the form of lien documents in Sweden, see question 35.

38 Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

Interest is usually charged on a spread over STIBOR (Stockholm interbank offered rate).

There is no legally set rate that is stated to be usurious. Charging usurious rates can be a criminal offence; however, this is very unlikely to be the case in commercial relations. A court of law may, however, based upon a determination of what is reasonable in the specific case, find a rate to be usurious and as a consequence hereof find it necessary to adjust it.

39 Loan default and enforcement

How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

In order for a creditor to obtain an enforceable remedy against a debtor, the creditor needs to obtain a writ of execution. A writ of execution is obtained by the creditor filing an application for an injunction to pay, addressed to the Swedish Enforcement Authority. The application is communicated to the debtor who may dispute the claim. If the debtor remains passive or admits the claim, the claim is considered established. Thereby the property will be considered seized and the verdict is considered both a writ of execution and a decision of seizure. If, however, the debtor disputes the claim, the dispute shall be submitted to the district court for a full hearing of the case.

If the property is seized, the creditor exercises its writ of execution by requesting a sale within two months from the date the verdict or the judgment regarding seizure gained legal force; otherwise the verdict loses its power to seize the property. Auctions under a writ of execution are handled by the Swedish Enforcement Authority. If the property is sold, the creditor will, provided that the proceeds from the sale cover any other creditor's (with a better right in the property than the original creditor) claims, receive payment for his or her claim up to an amount corresponding to 115 per cent of the face value of the mortgage certificates pledged in his or her favour including interest calculated from the time of the seizure of the property.

40 Loan deficiency claims

Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

As long as the lender gives notice to the borrower within the statute of limitations a borrower will always be liable for the full loan. See also question 42.

41 Protection of collateral

What actions can a lender take to protect its collateral until it has possession of the property?

Provided there is sufficient ground a lender may request that the Swedish Enforcement Authority, or a trustee assigned by the authority, collects rent due for payment during a foreclosure. In such case the Swedish Enforcement Authority must, without delay, notify the borrower that it is prohibited from paying to other than the authority or the trustee. The concept of mortgagee in possession is not recognised

under Swedish law. For seizure of property, see question 39. For receivership and bankruptcy, see question 14.

42 Recourse

May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

Recourse is not limited to the collateral, meaning that if a lender still has a claim against a borrower after the collateral has been seized and sold, the lender has every right to demand payment for any remaining claims (even though such amounts are not secured by a particular collateral). In terms of personal recourse for guarantors it will depend on how the guarantee is worded.

43 Cash management and reserves

Is it typical to require a cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

A loan document will typically include regulation of where the borrower's bank accounts are to be set up and how the accounts and cash flows of the borrower are to be structured.

44 Credit enhancements

What other types of credit enhancements are common? What about forms of guarantee?

Commonly used credit enhancements are guarantees from other companies within the borrower's group of companies. It should be noted that the Companies Act prohibits certain loans and providing of security from a limited company to its owners or other companies with the same owner. Groups of companies are, under certain circumstances, exempt from the said prohibition.

Non-recourse carve-out guarantees, also known as 'bad boy' guarantees, are not common in Sweden; see question 42.

45 Loan covenants

What covenants are commonly required by the lender in loan documents?

Commonly used covenants in loan documents include, among others:

- obligations to obtain and comply with all necessary authorisations;
- compliance with all relevant legislation;
- negative pledge;
- prohibitions to, without the lender's consent, incur further financial indebtedness;
- prohibitions, without the lender's consent, to dispose of assets;
- maintaining a comprehensive insurance cover;
- maintaining corporate status; and
- prohibitions to make loans or grant credits or guarantees to third parties.

Furthermore, the lender will usually demand information undertakings from a borrower, whereby the borrower will be obliged to supply financial and other information relevant for the lender's continuous appraisals of the borrower and the secured collateral.

46 Financial covenants

What are typical financial covenants required by lenders?

Typical financial covenants include debt-service coverage ratios and loan-to-value ratios. Lenders generally demand periodical valuations of pledged collateral.

47 Secured moveable (personal) property

What are the requirements for creation and perfection of a security interest in moveable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

Regarding requirements of creation and perfecting security interests, see question 35.

48 Single purpose entity (SPE)

Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

The use of SPEs is, for many reasons, quite common in real property-related transactions. The lender's requirements for the holding structures of real property investors vary depending on who the lender is and who the borrower is. Many borrowers use an SPE as borrower, which will then distribute the loan amounts within its group of companies.

The requirements for creating an SPE, such as a limited company or a limited partnership, are described above.

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General

1 Legal system

How would you explain your jurisdiction's legal system to an investor?

Switzerland has a civil law system, with most of the law regulated by statute. Compared with other jurisdictions, Swiss statutes, in particular older ones, are often short in style and leave room for interpretation and jurisprudence. In general, Swiss law allows parties to sue for specific performance or damages. Injunctions may be granted if the plaintiff can substantiate by prima facie evidence that the defendant is in breach or a breach is threatening and the plaintiff would suffer not easily remediable disadvantage from the breach.

Oral contracts are binding under Swiss law unless the law requires a specific form (such as for real estate contracts). As a general rule, courts are free to consider any form of evidence (documents, witnesses, site visits, experts, interrogation of the parties).

Real estate transactions are mostly regulated by federal law, but many relevant topics, such as zoning and taxes, are also governed by local regulations (ie, cantonal law and communal law).

2 Land records

Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

Switzerland has a land register, in which all rights in real property are registered. A bona fide purchaser of a property may rely on the fact that no other rights exist than the ones registered in the land register – with a few specific exemptions of legal liens, mostly for taxes or workmen's liens, that may exist independently of registration. This system makes title searches or title insurance as is customary in other jurisdictions unnecessary.

3 Registration and recording

What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

The acquisition of real estate (including building rights) requires the notarisation of a purchase agreement (signing) and the registration in the land register (closing). Ownership passes with registration in the land register.

Notaries in the canton where the property is located are exclusively competent to notarise sale and purchase agreements. In some German-speaking cantons the notaries for real estate matters are state officials. In other cantons the notaries are private practitioners. In two cantons the parties may choose between private and state notaries.

To convey title, notary fees, land register fees and in some cantons transfer taxes accrue. These fees and taxes vary from canton to canton and may be quite substantial in some cases (up to 3.5 per cent, even for larger properties). Depending on the canton, the fees are paid by the buyer or split equally between the parties.

No particular form is required for leases; leases are typically agreed in writing.

4 Foreign owners and tenants

What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

Swiss law restricts the acquisition of real estate that is not permanently used for commercial purposes (non-commercial property), such as residential or state-used property, unbuilt land or permanently vacant property (the Lex Koller). Foreign investors need a special permit in order to acquire non-commercial property. As permits are only available in a limited number of special cases, foreign investors are practically excluded from acquiring non-commercial property. The most relevant exemption in practice where permits are available is for foreigners to acquire a vacation home in certain tourist regions that expressly provide for such permits.

Legal entities with their corporate seat outside Switzerland are deemed as foreign under the regulations regardless of who controls them. Legal entities with their corporate seat in Switzerland are deemed as foreign if they are controlled by foreign investors. The law takes a very economic view to determine whether a Swiss entity is foreign-controlled, ie, it looks through the entire holding and financing structure, but is strictly formal as soon as an entity with its corporate seat outside Switzerland is involved.

Swiss nationals are considered to be Swiss irrespective of their place of residence. EU nationals are not considered to be foreign if they have their actual and legal residence in Switzerland. Non-EU nationals must hold residence permit C in Switzerland in order to be considered Swiss; they may, however, acquire a primary house at the place of their actual and legal residence beforehand.

Only property that is not permanently used for commercial purposes is subject to the legislation. Mixed property, for example, mixed residential and commercial property, may only be acquired if the residential use is clearly subordinate (for example, a caretaker's apartment in an office building) or if it is situated in a zone where the law prescribes a certain minimum residential use that is below 50 per cent.

5 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

There are no exchange control issues limiting investment in Swiss real estate or the repatriation of profits. However, Swiss banks are subject to strict anti-money laundering rules requiring them to trace the source of monies transferred to Switzerland. Also, repatriation of monies as dividends or liquidation proceeds from a Swiss company is subject to a withholding tax of 35 per cent, which non-resident shareholders may only partly or fully reclaim if a double taxation treaty so provides.

6 Legal liability

What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

Swiss law has strict liability (in tort) of the owner of a building for damages resulting from deficiencies or insufficient maintenance of a property. Similarly, tenants may become liable for deficiencies or insufficient maintenance of tenant fittings. Lenders are typically not liable.

7 Protection against liability

How can owners protect themselves from liability and what types of insurance can they obtain?

Owners typically take out insurance against building liability risk; insurance is, however, not mandatory. Tenants would typically seek coverage under a general private or business liability policy. Environmental risks are typically not separately insured.

8 Choice of law

How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

Agreements on real property located in Switzerland must follow the formal requirements of Swiss law (ie, public notarisation at the place of the property, governing version in the official language of the place of the property). Also, rights in rem on real property in Switzerland are mandatorily subject to Swiss law. In the absence of a choice of law provision, Swiss law also applies to the agreement itself. While a choice of law provision is theoretically enforceable, local notaries in practice often refuse to notarise agreements that are not subject to Swiss law.

For lease agreements, a foreign law may be chosen as governing law (subject to a few public order provisions that apply mandatorily).

9 Jurisdiction

Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

Swiss courts have exclusive jurisdiction on rights in rem in real property in Switzerland. Proceedings are started by filing a statement of claim with the relevant court; service of process is exclusively made by the court. A party does not have to be qualified to do business in Switzerland to enforce remedies.

For lease disputes, the law provides for a special mediation authority that must be consulted to start legal proceedings and for special lease courts as courts of first instance. The mediation authority or court where the property is located has jurisdiction. A choice of arbitration is permissible.

10 Commercial versus residential property

How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

Apart from the general restrictions on the acquisition of non-commercial real estate by foreigners (Lex Koller) and zoning laws, Swiss law barely differs between commercial and residential property. Some differences exist in lease law: for example, the minimum notice period for termination is three months for residential and six months for commercial property, and the maximum period by which a lease may be extended by the court upon request by the tenant is respectively four and six years.

11 Planning and land use

How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

Zoning law is regulated by federal, cantonal and communal regulations, with detailed zoning being regulated at community level. Building projects require a building application that is reviewed in a process that may be lengthy for larger projects, as well as the publication of the project and setting of building profiles so that neighbours and environmental organisations can appeal against the building permit.

12 Government appropriation of real estate

Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

Condemnation of real estate is practically only relevant for infrastructure projects such as roads, railways and similar. Owners that are subject to condemnation receive compensation that is assessed in a judicial process if no agreement is reached. In condemnations based on federal law, the compensation is distributed among the lenders and other holders of rights in rem according to the priority of their rights in rank and the remainder to the owner.

Tenants may claim compensation if their lease agreement is terminated early or the use of the lease object during the lease term is impaired by the condemnation.

13 Forfeiture

Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

Real estate can only be forfeited by the court in a criminal proceeding if the property was acquired through a criminal offence. The right to order forfeiture is limited to seven years, unless the statute of limitations for the offence is longer, in which case this longer deadline applies. No forfeiture may be ordered if a bona fide purchaser has acquired title in the property.

14 Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency system in your jurisdiction.

Swiss law provides for involuntary and voluntary bankruptcy of Swiss legal entities. When enforcing its claim, a secured creditor may choose whether to sue for foreclosure of the security (resulting in the liquidation of the security) or for payment of the claim (resulting in bankruptcy). A lender secured by mortgage notes would typically choose the first. An unsecured creditor, for example the lessor, would sue for bankruptcy. Both proceedings are started with an order to pay being issued to the debtor; the debtor has the possibility to object, which would lead to legal proceedings on the merits of the claim.

The directors of Swiss companies are obliged to file for voluntary bankruptcy or request a moratorium if the company is overindebted, ie the company's liabilities exceed its assets. Such a voluntary bankruptcy may also be started during a pending debt enforcement proceeding. A secured creditor's preferential right remains respected in the bankruptcy or moratorium.

Investment vehicles

15 Investment entities

What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

In principle, any Swiss or foreign entity may acquire real estate in Switzerland. Typically a Swiss company limited by shares (AG/SA) or limited liability company (GmbH/Sarl) is chosen to shield the investor

from liability. While both types of entities are taxed on an individual basis in Switzerland, a GmbH/Sarl is sometimes preferred by US investors as it is regarded as a pass-through entity for US tax purposes.

16 Foreign investors

What forms of entity do foreign investors customarily use in your jurisdiction?

Foreign investors typically directly acquire real estate with a foreign entity or use an AG/SA or GmbH/Sarl. The direct acquisition has the advantage that no withholding tax applies to distributions. The use of a Swiss property company has the advantage of being better acceptable as a counterparty in Switzerland.

17 Organisational formalities

What are the organisational formalities for creating the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

Swiss companies are formed in an incorporation meeting held in the presence of a notary public and registration in the commercial registers. While the preparation of the articles of association and documentation for the meeting can be arranged within days, the payment of the minimal capital to a blocked account and the collection of proxies and signatures may require more time.

Foreign entities holding real estate in Switzerland are not subject to special registration or reporting requirements. They are in principle subject to the same duties as Swiss companies, which includes the filing of ordinary tax returns and registration for VAT purposes, if applicable. The acquisition of real estate establishes a limited tax residence in Switzerland for income and capital tax purposes.

Acquisitions and leases

18 Ownership and occupancy

Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

Most owned properties are held in full ownership (similar to freehold), in which case the owner has full title to the land and buildings. Other properties are held as a building right (similar to a land lease or leasehold); in this case, the landowner grants to the lessee the right to erect and maintain buildings on the land. Such building rights can be agreed for up to 100 years. At the end of the term, the buildings accrue to the landowner – depending on the agreement – with or without compensation. Building rights are transferable and are traded similarly to properties in full ownership.

Both full ownership properties and building right properties may be split into co-ownership or condominiums. In case of co-ownership, each co-owner owns a proportional quota in the entire property. Each co-owner thus participates in the income of the entire property with his or her quota.

In the case of condominium property, each owner has the right to use certain rooms exclusively. Each owner thus profits from the use and income of his or her unit. Furthermore, each owner may use the common areas (entrance, stairs, etc).

Leased properties are used based on a lease agreement that is subject to the lease provisions of the Code of Obligations. Swiss lease law and courts are rather tenant-friendly. Commercial properties are usually leased based on a lease for a fixed term (often five to 10 years). Residential properties are typically leased based on indefinite leases that can be terminated by either party with a notice period of three months.

19 Pre-contract

Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

In the residential property market, sellers typically request the buyer to sign a type of reservation agreement and pay a reservation fee in the range of 20,000 to 50,000 Swiss francs that is forfeited to the seller if no binding agreement is signed. In return, the seller typically takes the property off the market. As sale and purchase agreements must be executed in the form of a public deed in order to be binding, it is questionable to what extent such reservation agreements are enforceable or whether the buyer may reclaim a reservation fee he or she paid.

For commercial properties, pre-contracts are not typical among Swiss institutional investors as they are unenforceable if not executed in the form of a public deed. Swiss investors typically prefer to negotiate the final agreement based on a formal offer (normally labelled as 'binding', although it is not binding) submitted by the buyer. When foreign investors are involved, we see term sheets, letters of intent and (non-binding) pre-agreements that are subject to contract, due diligence and other conditions. In such agreements, sellers sometimes grant exclusivity for a limited period of time.

20 Contract of sale

What are typical provisions in a contract of sale?

Contracts still widely follow local notary practice, are rather short and more or less standardised among institutional investors. The contract typically includes:

- description of the property (as taken from the land register);
- purchase price and payment details, often with part of the purchase price payable directly to financing banks for the repayment of existing mortgages or to tax authorities as a deposit for real estate gain taxes;
- the closing mechanism: among Swiss investors, sales are often signed and closed on the same day. A separate closing is chosen if the buyer must secure financing or in case of pre-emptive rights;
- payment of notary fees, land register fees and transfer taxes;
- apportionment accounts between seller and buyer for periodic income and duties such as lease income, insurance premiums, taxes, energy costs and service charges;
- transfer of certain agreements (service agreements, facility management, property management);
- VAT; and
- payment of real estate gains tax by the seller – often directly paid by the buyer to the tax authorities, in deduction from the purchase price.

All warranty provided by law is regularly fully excluded. Instead the parties agree on a limited set of representations and warranties. These include typically:

- no legal liens for taxes, workmen's liens and the like;
- no pending or threatened litigation regarding the property; and
- representations rebadging environmental matters (see question 21) and leases (see question 22).

21 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

Existing properties without known environmental issues are typically sold without any warranty regarding environmental pollution or with only a representation that the property is not registered in the register

of contaminated sites and that the seller has no knowledge of any existing contamination.

For development projects or existing properties with known environmental issues, different solutions are seen: in some cases the seller agrees to bear the costs of remediation; in other cases, the buyer agrees to bear the costs of remediation (in full or up to a certain level), but the purchase price is reduced to reflect the likely costs of remediation.

If nothing is agreed (and any warranty has been excluded), the clean-up cost must be paid by the owner of the property (ie, the buyer if remediation takes place only after the closing). The seller may, however, become liable for the full or part of the remediation costs based on public law if he or she caused the pollution or if the pollution occurred during his or her time of ownership or occupancy.

22 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

According to mandatory Swiss law, lease agreements are transferred by operation of law to the new owner in the case of a property sale. The new owner may, however, terminate the lease early as per the next statutory termination date in case of urgent need of the property for its own purposes. As the seller as former lessor must compensate the tenant with damages in the case of such early termination by the buyer, the buyer typically undertakes in the purchase agreement not to exercise its right to terminate early. An early termination may also be excluded by registering the lease in the land register prior to the sale.

The sale and purchase agreement typically contain representations that:

- the net rental income as per the rent roll is correct;
- no material written and oral side agreements exist;
- no terminations have been received or threatened in writing;
- no tenant has requested in writing a reduction in rent;
- no extraordinary arrears in rent exist;
- no disputes or litigation with tenants exist or have been threatened in writing; and
- all rental guarantees and deposits provided for in the lease agreements exist and will be transferred to the buyer upon closing.

Estoppel certificates are not used in Switzerland.

23 Leases and real estate security instruments

Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

Lease agreements are transferred by operation of law to the new owner if the property is sold in the course of the foreclosure. The new owner may, however, terminate the lease early as per the next statutory termination date in case of urgent need of the properties for own purposes, unless the lease has been registered in the land register. If the secured creditor cannot be fully satisfied from the proceeds of the public auction for the liquidation of a property because of a lease registered in the land register that has been registered after the mortgage has been registered, the property is again auctioned without such registration – if the auction proceeds are higher this way, the property is sold without registration so that the new owner retains the right to terminate early.

24 Delivery of security deposits

What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

Lease agreements in Switzerland do typically provide for security in an amount between one and three (residential leases) or three and 12 (commercial leases) monthly leases. The security is typically granted in the form of a security deposit or a bank guarantee. A security deposit must by law be paid to a special blocked bank account in the name of the tenant over which the parties can only dispose jointly; in the case of sale of the property, the deposit is 'transferred' by instructing the bank of the new owner or lessor. Guarantees (in the form of a bank guarantee or surety by a bank) must typically be reissued in the case of a sale.

Periodic rent resets or reviews are not common in Swiss leases, and Swiss law also restricts the amount by which the lessor may raise the rent. In leases with a minimal fix duration of five years, it is, however, possible to agree on a predefined staggered rent or a periodic adjustment of the rent to the consumer price index (but not for both).

25 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain a zoning report or legal opinion regarding legal use and occupancy?

Because of the land register system, due diligence for the acquisition of the property is often relatively simple, which makes title searches or title insurance as is customary in other jurisdictions unnecessary.

Reports on zoning or opinions regarding compliance with building regulations are rarely seen for property with existing buildings, but more common for development projects unless a recent building permit exists.

26 Structural and environmental reviews

Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

As all warranties for the condition of existing buildings are typically excluded in the sale and purchase agreement, reports on the building's condition (in particular CAPEX requirements) are often sought by institutional investors.

Environmental reports are often limited to a Phase 1 report, but may go deeper in case of known water or soil contamination or for development projects. Environmental insurance is not common in Switzerland.

27 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

Leases are typically reviewed both by the business and the lawyers, with the legal review focusing on the type of lease (tenant fittings, distribution of costs), early breaks, restrictions in use, lease assignment and sub-lease clauses and change of control clauses.

28 Other agreements

What other agreements does a lawyer customarily review?

The main focus of the legal due diligence lies on the land register documents, including the supporting documents that show the terms of servitudes and easements encumbering the property. Maintenance agreements, service agreements, insurance agreements and other ancillary agreements are normally only cursorily reviewed, as these agreements are often fairly standard.

29 Closing preparations

How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

For the signing and closing of an acquisition, each party must provide power of attorney and evidence of its corporate existence (with an excerpt from the commercial register or, for entities from jurisdictions without a commercial register, certificate of incorporation and company secretary certificate). The seller's counsel further typically provides the annexes to the agreement (such as the rent roll) and confirmation by the tax authority about the real estate gains taxes resulting from the transaction, and arranges for the transfer of the mortgage notes (duly endorsed in the case of registered mortgage notes). The buyer's counsel arranges for the payment of the purchase price to the notary's account or the delivery of a payment undertaking by a Swiss bank.

The signing and closing of leases is less formal as neither public notarisation nor registration is required. Leases are often signed by circulating execution copies by ordinary mail or courier. At the start of the lease, the parties or their representatives typically meet in person at the premises for the handover to document the condition of the premises in minutes signed by both parties – lawyers are usually not present at the handover. Most importantly, the lessor should insist that the rental security is granted prior to handing over the keys.

Financings are usually signed by exchanging execution copies by mail or email. Lawyers are often involved in the preparation of the security documents, in particular if new mortgage notes need to be established and registered in the land register.

30 Closing formalities

Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

A sale and purchase agreement is closed by registering the transfer in the land register. In cantons with private notaries, the registration is normally made by the notary who notarised the purchase agreement; to secure the payment, the purchase price is typically paid to the notary and released once the transfer is registered. Mortgage notes that must be released by the seller's bank but are needed to secure the financing of the buyer's bank are also sent to the notary who holds them in escrow.

In cantons with state notaries, the parties often meet in person at the land register office. To secure the payment, the buyer presents a payment undertaking by a (typically Swiss) bank in which the bank guarantees to the seller that the payment of the purchase price is made immediately after registration. Mortgage notes are here often transferred directly between the banks – be it before the payment in reliance on a payment undertaking or after the payment based on a promise by the seller's bank to transfer the mortgage notes to the buyer's bank immediately after receipt of payment.

31 Contract breach

What are the remedies for breach of a contract to sell or finance real estate?

Swiss law provides for specific performance. A buyer may thus sue the non-performing seller for transfer of ownership against payment of the purchase price and in addition for damages for late delivery. As an alternative, the buyer may terminate the agreement and sue for damages. Similarly, a seller may sue the non-performing buyer for the payment of the purchase price including damages for late payment against the transfer of ownership. Alternatively, the seller may terminate the agreement, retain ownership of the property and sue for damages for non-performance.

32 Breach of lease terms

What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply?

Leases of real property are governed by the lease provisions of the Code of Obligations. In general, early termination by the lessor is only possible if the tenant's breach makes it unacceptable for the lessor to continue the lease. In case of non-payment of rent by the lessee, the lessor must set a deadline no less than 30 days for payment in writing and threaten to terminate if the outstanding amounts are not paid. If no payment is received within the deadline, the lessor may terminate with a notice period of 30 days. After valid termination, the lessor may start proceedings to evict the tenant.

If a termination is not possible, the parties may ask for specific performance (for example, the repair of defects of the leased property), damages or a reduction in rent.

Financing

33 Secured lending

Discuss the types of real estate security instruments available to lenders in your jurisdiction.

Real estate financings are typically secured by mortgage notes registered on the property. Mortgage notes grant the creditor a lien on the property in the amount specified in the mortgage notes. Mortgage notes are transferable and may be used as collateral for a subsequent lender after repayment.

In addition, commercial real estate financings, especially by non-Swiss banks, are typically secured by an assignment of rents and other claims, the assignment or pledge of bank accounts and sometimes a pledge of the share of the property company.

34 Leasehold financing

Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

The acquisition of a building right is typically financed in the same way as the acquisition of full ownership in land. Financing is available for the purchase price, but not for the recurring lease payments.

Rental agreements are not financed by lenders. The financing of tenant fittings is typically made in the form of a loan for general business purposes, as it is not practically possible to pledge tenant fittings (see question 47).

35 Form of security

What is the method of creating and perfecting a security interest in real estate?

Nowadays, real estate financing is almost exclusively secured though mortgage notes. Mortgage notes may be issued in the form of paper securities in the bearer or registered form or as paperless mortgages registered in the land register only.

36 Valuation

Are third-party real estate appraisals required by lenders for their underwriting of loans? Must appraisers have specific qualifications?

Third-party real estate appraisals are not required by law for the financing of real estate. Some lenders do nevertheless request such appraisals in commercial financing transactions. In any case, capital adequacy regulations require banks to assess the value of the property at least by an internal valuation.

Some institutional investors, in particular Swiss investment funds, require an independent third-party appraisal for the acquisition of real estate; other investors have such requirements in their internal regulations. Financing banks regularly request the disclosure of appraisals in such cases.

37 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

Foreign lenders may in principle make loans secured by Swiss real estate without a special qualification to do business in Switzerland being required, provided that lenders do not have infrastructure or employees in Switzerland. However, foreign lenders may face certain tax disadvantages: borrowers of a loan by a non-Swiss-resident lender that is secured by Swiss real estate must withhold the federal and cantonal income tax of roughly 13 to 33 per cent of the interest at source. The tax at source on interest income is reduced to zero under a number of double taxation treaties, including ones with France, Germany, Luxembourg, the UK and the US.

The creation of new mortgage notes leads to notary fees, land register fees and in some cantons even taxes. The fees are substantial in some cantons. Mortgage notes are thus usually not deleted in the land register but transferred to a new lender in case of a refinancing – in general, no fees accrue in this case.

38 Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

Interest rates are typically set as LIBOR plus a margin, nowadays often with the caveat that LIBOR may never be less than zero. Federal law does not have maximum interest rates that would apply to other than consumer credit loans, but the interest may be considered as usurious in extreme cases. Some cantons have interest rate limits – for example, the maximum interest rate is 18 per cent in the canton of Zurich.

39 Loan default and enforcement

How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

Outside the insolvency of the borrower, the lender would typically start debt enforcement proceedings for the foreclosure on the property, in which the borrower has several possibilities to object. In particular, the debt enforcement officer will set the borrower a final deadline of six months to pay prior to organising a public auction to liquidate the property. The enforcement of a security in the property thus takes time.

If claims have been assigned for security purposes, lenders would typically also notify third-party debtors (such as tenants, banks and insurance companies) of the assignment of claims so that the amounts are directly paid to the lender.

The debtor may in principle file for bankruptcy or request that a moratorium process be started at any time during the process. Such proceedings have effects on the proceedings for the liquidation of the property, but do not affect the preferential right of the secured lender to the proceeds from the property.

40 Loan deficiency claims

Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

Outside the bankruptcy of the borrower, the borrower is liable for the full amount of the loan plus interest and other permitted additions and must compensate the lenders for any deficiency to the amount recovered in the foreclosure.

41 Protection of collateral

What actions can a lender take to protect its collateral until it has possession of the property?

Outside an insolvency proceeding, in an ordinary debt enforcement proceeding with a view to foreclosure, the bailiff will register a transfer restriction in the land register and must take over the administration (property management) of the property. If rents have been assigned to the lender for security purposes, the lender may also notify the tenants so that the rents can be directly paid to the lender.

In a bankruptcy proceeding, the bankruptcy administration will take control of the debtor and thereby the property. Similarly, in moratorium proceeding, the administrator will supervise the debtor, and the sale of fixed assets (including investment properties) is excluded without the consent of the court.

42 Recourse

May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

Claims from loan financings are ordinary personal claims against the borrower under Swiss law, so that recourse against the borrower is not limited. Non- or limited-recourse loans are unusual in Switzerland and must be specially agreed. In an insolvency situation, however, the lender will benefit from the proceeds of other than secured assets only pari passu with other non-preferred creditors.

43 Cash management and reserves

Is it typical to require a cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

Cash management systems are not usual in financing by Swiss banks, but foreign lenders sometimes require such systems based on the practice in their home country.

44 Credit enhancements

What other types of credit enhancements are common? What about forms of guarantee?

Other credit enhancements such as guarantees are not common in Swiss real estate financings.

45 Loan covenants

What covenants are commonly required by the lender in loan documents?

Loans by Swiss lenders are often rather lean and do not contain comprehensive covenants. Generally, the following are most seen:

- no insolvency of the borrower, no foreclosure on secured property;
- no disposal of secured property;
- no change of use of the secured property;
- no assignment of rents;
- adequate insurance coverage;
- adequate maintenance of the property;
- no default in payment of principal or interest;
- financial reporting and other information requirements (in particular rent roll); and
- pari passu clause, negative pledge.

46 Financial covenants

What are typical financial covenants required by lenders?

Most Swiss real estate financing contain an explicit (or at least implicit) loan-to-value covenant. Interest cover ratios are sometimes agreed in larger financings, as are financial reporting requirements (typically annually or semi-annually).

47 Secured moveable (personal) property

What are the requirements for creation and perfection of a security interest in moveable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

With the exception of shares, moveable property (such as furniture, fixtures and equipment, tenant fittings) is hardly ever used as security for real estate financings. Swiss law requires the lender to have possession and physical control over moveable property for a pledge or security transfer to be valid; in most cases, this excludes the possibility that moveable property be taken as security.

The assignment of claims is common (in particular rents and insurance claims and (less commonly) bank accounts and warranty claims). IP or other rights are hardly ever used as security in real estate transactions. The assignment of claims requires a written agreement; the notification of the debtor is not required (and thus not often made prior to an event of default), but has the effect that the debtor may only pay the assignee in order to be released.

48 Single purpose entity (SPE)

Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

Lenders do usually not require that each borrower be an SPE, but SPEs are often chosen by investors to enable them to exit by way of a share deal. There is no special regulation of SPEs in Switzerland; the ordinary rules of company law apply.

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Thailand

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General

1 Legal system

How would you explain your jurisdiction's legal system to an investor?

Thailand has a civil law system. Emergency orders and temporary injunctions are theoretically possible at any time before judgment is entered, but they are rarely granted. The court must be satisfied that the complaint is justifiable and that sufficient extenuating circumstances exist. Equity is not separated from law, nor does it have that name. The doctrine of strict compliance with judicial precedent does not apply, and there is no jury system in Thailand. Discovery procedures are not yet a part of the legal environment. Oral testimony is not sufficient, and some written evidence of an agreement signed by the liable party is required to enforce the following contracts:

- agreement to sell or buy property, which must be registered by a competent official;
- sale of moveable property where the agreed price is 20,000 baht or more;
- lease of immoveable property for more than three years;
- mortgage;
- loan of a sum exceeding 2,000 baht;
- suretyship;
- compromise; and
- insurance.

All other contracts for which the law does not specifically provide forms may be executed orally.

2 Land records

Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

Thailand only has a system for the registration of interests, and failing to register the transfer of ownership makes the transaction void.

In cases of failing to register a lease of property with a lease term of more than three years, the lease term is automatically reduced to three years. Leases with a term of three years or less do not require registration.

Failure to register the mortgage will void the transaction.

Failure to register security interests will not void the transaction between the parties, but the security interests will not be enforceable against third parties.

The registration of an ownership, a leasehold, or a security interest with the relevant Land Office guarantees both title and priority to the registering party.

3 Registration and recording

What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

Legal requirements for registration of conveyances, leases and real estate security interests include execution of a land sale, lease or security interest agreement with the relevant Land Office, and payment of the applicable fees and taxes at the Land Office.

The rules for registration are the same for each province, but their application may differ slightly from land office to land office, since the interpretation of the rules is at the discretion of the competent official.

Fees and taxes to be paid for conveyance of title are:

- a transfer fee: at the rate of 2 per cent of the price of the land as appraised by the relevant land office;
- income tax: generally, property must be transferred at a price not lower than its market value (ie, the price as appraised by the Land Department). Capital gain, if any, derived from the transfer of assets is subject to corporate income tax. Corporate income tax is generally imposed at the rate of 20 per cent of net profits (accounting period 2014–15). Reduced rates of 15 per cent are granted to small and medium-sized enterprises (companies with paid-up capital not exceeding 5 million baht) with net profits not exceeding 1 million baht;
- withholding tax: a corporate withholding income tax of 1 per cent of the selling price or the price as appraised by the Land Department, whichever is greater, is imposed on the transfer of immoveable assets. The transferee is obliged to withhold this tax and remit the same to the competent official at the time of registration of rights and juristic acts. This 1 per cent withholding tax is regarded as an advance tax payment that can subsequently be used by the transferor as credit against the corporate income tax payable;
- specific business tax (SBT): the transfer of immoveable property is subject to SBT imposed at the rate of 3.3 per cent (this rate includes municipal tax) of the selling price or the price as appraised by the Land Department, whichever is greater; and
- stamp duty: the transfer of immoveable property is subject to stamp duty of 5 per 1000 baht (0.5 per cent) of the selling price or the price as appraised by the Land Department, whichever is greater. If SBT has already been paid for the transfer, the transfer will be exempt from stamp duty.

Fees and taxes to be paid for the registration of a lease are:

- registration fee: at the rate of 1 per cent of the total rental fee for the whole lease period; and
- stamp duty: the lease of immoveable property is subject to stamp duty of 1 per 1000 baht (0.1 per cent) of the selling price.

Fees to be paid for the registration of a mortgage are:

- registration fee: at the rate of 1 per cent of the mortgage amount with a maximum of 200,000 baht.

4 Foreign owners and tenants

What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

In general, foreign nationals cannot own land in Thailand. Under Thai law, a 'foreigner' is defined as:

- a natural person who is not of Thai nationality;
- a juristic entity that is not registered in Thailand;
- a juristic entity incorporated in Thailand with foreign ownership accounting for half or more of the total number of shares or registered capital; or

- a limited partnership or ordinary registered partnership whose managing partner or manager is a foreign national.

Buildings and any other structure on the land may be owned, and separate title registrations over such buildings are possible. Thai law also allows foreign nationals (individual or corporate) to directly own up to 49 per cent of the aggregate unit space of a condominium building. In addition, foreign majority-owned companies located in an industrial estate or that have received investment promotion from the Board of Investment may be allowed to own land for their business.

These restrictions do not apply to foreign tenants, since foreign nationals are allowed to lease property in Thailand under the same rules as Thai nationals.

5 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

Unlimited amounts of Thai baht or foreign currency may be brought into Thailand; however, as a general rule, such foreign currency must be sold to or converted into baht by authorised dealers (authorised banks, authorised companies or authorised persons) located in Thailand or deposited into a foreign currency account, with authorised commercial banks or authorised companies located in Thailand, within 360 days from the date of acquisition or importation. Funds remitted into Thailand for the purchase of condominium units must be remitted in foreign currency.

Commercial banks are authorised by the Bank of Thailand to approve outward remittance, in its name, including:

- remittance of an unlimited amount in repayment of a foreign loan and payments of accrued interest and other related fees and costs, net of all taxes, with proper documentary evidence;
- unlimited remittance of proceeds from a sale of shares with the required documentary evidence; and
- remittance of an unlimited amount in payment of certain types of service fees, including transport and communication, with appropriate documentary evidence.

When purchasing foreign currency for one of these purposes in an amount exceeding US$50,000 or its equivalent, a foreign exchange transaction form must be submitted to authorised banks, together with appropriate supporting documentary evidence. Foreign exchange transactions involving amounts in excess of the above limitations, or for purposes other than those mentioned above, require the approval of the Bank of Thailand.

6 Legal liability

What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

The seller is liable for any defect of sold property that impairs either its value or its fitness for ordinary purposes, or for purpose of contract, except in the following circumstances:

- if the buyer knew of the defect at the time of sale or would have known if such care as might be expected from a person of ordinary prudence had been exercised;
- if the defect was apparent at the time of delivery and the buyer accepted the property without reservation; or
- if the property was sold by auction.

If the buyer has discovered defects in property sold, he or she is entitled to withhold the price or part thereof unless the seller provides proper security. The buyer is also entitled to withhold the price, in whole or in part, if he or she is threatened, or has good reason to believe that he or she is about to be threatened, with action by a mortgagee or by a person claiming property sold, until the seller causes such threat to cease or gives proper security.

In a sale of immoveable property where the total area is specified and the seller delivers the property for less or more than he or she contracted for, the buyer has the option to reject or accept it and pay the proportionate price. If the deficiency or excess does not exceed 5 per cent of the total area so specified, the buyer is bound to accept it and pay the proportionate price, provided that the buyer can rescind the contract if the deficiency or excess is such that had he or she known of it he or she would not have entered into the contract.

Action for liability for defect or liability on account of deficiency must be taken within one year after delivery. The seller is liable for consequences of any interference with the right of peaceful possession of the buyer by any person having a right over property sold, except where the buyer knew at the time of sale that the right of the person causing disturbance existed.

Under the wrongful act doctrine of Thailand's Civil and Commercial Code (CCC), a party who unlawfully injures another as a result of wilful or negligent conduct is said to commit a wrongful act. The injuring party is liable to compensate the injured for damages resulting from that act. If damage is caused by reason of the defective construction or insufficient maintenance of a building or other structure, as well as in the planting or propping of trees, the possessor of such building or structure is bound to make compensation. However, if the possessor has used proper care to prevent the occurrence of the damage, the owner is bound to make compensation. If there is also some other person who is responsible for the cause of the damage, the possessor or owner may exercise a right of recourse against such person.

A tenant is liable to the lessor for any injury resulting from a delay in informing the lessor if:

- the property is in need of repairs;
- a preventive measure is required for avoiding danger; or
- a third person encroaches on the property or claims a right over it.

A tenant is also liable to the lessor for any loss or damage that may result from alterations or additions to the property the tenant made without permission of the lessor, as well as for any damage caused to the property by his or her own fault or by the fault of persons living with him or her or by his or her subtenants.

There are no specific liability rules for lenders on real estate.

7 Protection against liability

How can owners protect themselves from liability and what types of insurance can they obtain?

An agreement for exemption of liability for defects or disturbance is enforceable. Unless the non-liability clause specifies otherwise, such clause does not exempt the seller from the repayment of the price. Furthermore, a non-liability clause cannot exempt the seller from consequences arising from his or her own acts or facts that he or she knew and concealed. Environmental problems are generally excluded from all-risk insurance.

8 Choice of law

How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

Under the Thai conflict of laws rules, the law of the country where a property is situated governs the form required for the validity of a contract, document or other juristic acts relating to immoveable property. Contractual choice of law provisions pertaining to properties located in Thailand that choose the law of a different country are not enforceable.

9 Jurisdiction

Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

There is no specialised court or other tribunal in relation to real estate disputes. Where a dispute is a civil action, it may be commenced by filing a complaint (known as a plaint) with the court of first instance having territorial jurisdiction. A civil case in connection with a criminal offence may be brought either in the court where the criminal case is being tried, or in a court competent to try civil cases. Two or more

persons may join in an action as joint plaintiffs and may be joined as joint defendants where there are common interests in the subject matter of a suit.

At time of filing the complaint, the plaintiff must deposit court fees in an amount determined by the nature of the action and the amount of relief requested. For claims, the court fee is 2.5 per cent of the claimed amount but shall not exceed 200,000 baht.

Within seven days from acceptance of the complaint, the plaintiff must request the appropriate officer to serve a summons to answer, with a copy of the complaint, on the defendant. Service may be made on the defendant at his or her domicile or place of business, in court or by the defendant's acceptance of service. When service cannot be made, the court may issue an order for substituted service, by posting, advertisement or otherwise, and service is effective 15 days after completion of such substituted service.

In actions against a non-domiciliary defendant, service is made by sending process to the defendant's foreign office or domicile. In the absence of contrary provisions in an international treaty to which Thailand is party, the plaintiff must provide a translation of the summons and complaint and other documents to be served in the official language of the country in which service is to be made or in English, together with a certification of accuracy of translation and deposit for expenses to be fixed by the court. Again, in the absence of an international agreement providing otherwise (Thailand is not party to the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters 1965), the court will arrange service through the Ministry of Justice and Ministry of Foreign Affairs. Service will be effective 60 days after the date of such service. Where the non-domiciliary defendant conducts business in Thailand, directly or by agent, or by written agreement has designated an agent for service in Thailand, service may be sent to the defendant, his or her business or his or her designated agent at the location of the business of the defendant or the agent's residence. Service on a non-domiciliary defendant is effective 30 days after the date of such service.

A party need not be qualified to do business in Thailand to enforce remedies in Thailand. However, as Thailand is not party to any treaties or conventions on enforcement of foreign judgments, foreign judgments are not enforceable. Authenticated copies of foreign judgments may be received in evidence at trial. Thailand is party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958) and the Geneva Convention for the Execution of Foreign Arbitral Awards (1927). A final foreign arbitration award rendered in a proceeding wholly or mainly in a foreign country, reciting all matters required by applicable convention, may be recognised and enforced if it is not contrary to public policy or morality. The court may refuse enforcement on proof of defences such as:

- annulment, invalidity or lack of finality of award;
- lack of adequate notice during arbitration proceedings;
- an award beyond the scope of, or not disposing of, issues submitted under an arbitration agreement; or
- an arbitration proceeding conducted other than in accordance with the agreement of the parties or the law of the country in which the arbitration took place.

10 Commercial versus residential property

How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

Generally, Thai law treats commercial property and residential property in the same way. There are, however, the following differences between leasing residential and commercial property (provided the lease has been properly registered as a lease for commercial or industrial purposes with the competent officer):

- The maximum lease term for a residential property is 30 years, whereas it is 50 years for a property for industrial or commercial purposes.
- A residential lease can generally not be mortgaged as a security for financing, whereas a lease for industrial or commercial purposes can be mortgaged as a security, under application of the mortgage rules for immoveable property mutatis mutandis.
- A residential lease terminates upon the death of the lessee, whereas a lease for industrial or commercial purposes can be inherited by the heir of the lessee.
- Transfer of the lease right to third parties or sublease of a residential property requires the consent and cooperation of the lessor, whereas the lessee of a property for commercial or industrial purposes has the right to sublease or transfer the right to lease, wholly or partly, to a third person, unless it is specifically stated otherwise in the lease agreement.

11 Planning and land use

How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

The Building Control Act and the Town and City Planning Act regulate development, construction, and the permissible uses of land in different zones. This zoning regime is specified in greater detail through ministerial regulations issued under the above-mentioned laws. Additional restrictions on the use of real estate can originate from environmental laws, such as the Enhancement and Conservation of National Environmental Quality Act or the Forest Act.

12 Government appropriation of real estate

Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

In case the state needs to acquire any immoveable property for the provision of necessary public utilities or national defence, for the acquisition of natural resources, for town and city planning, for the development of agriculture, industry or land reform, or for other public purposes, if the transfer of ownership of such immoveable property is not agreed upon otherwise, a property can be expropriated under the Immoveable Property Expropriation Act. A royal decree on demarcation of the area to be expropriated is then enacted prior to the expropriation. A survey of the land to be expropriated is undertaken and, within 30 days of completion of the survey, a committee is appointed, comprising a representative of the expropriating office, a representative of the Land Office, a representative of another state agency and a representative of the local assembly, in order to appraise the estimated price of the immoveable property to be expropriated and the amount of compensation to be paid.

The following persons are entitled to receive compensation:

- the owner of, or the person who is legally in possession of, the land to be expropriated;
- the owner of tenements or other constructions that cannot be demolished and existed on the land to be expropriated on the date the Royal Decree comes into force or constructed later by permission of the officer;
- the lessee of land, tenement, or other constructions on the land to be expropriated, but the lease contract shall be made in writing prior to the date the Royal Decree enacted under section 6 comes into force or made later upon the permission of the officer and such contract still is valid on the date the officer or his entrusted person takes possession of that land, tenement or construction. The compensation in this case shall merely be paid to the lessee who has to leave that land, tenement or construction prior to the termination of that lease contract;
- the owner of perennial plants on the land on the date the Royal Decree comes into force;
- the owner of tenement or other constructions that are able to demolish and existed on the land to be expropriated on the date the Royal Decree comes into force, but that person is not required to demolish that tenement or construction upon request of the land owner. Compensation shall be paid only for demolition, relocation and reconstruction; and
- any person who lost his or her right of way or his or her right to lay down water pipeline, drainpipe, electricity line or the like through the land to be expropriated but only in the case that the person pays

considerations in return for the use of that right to the owner of the land to be expropriated.

13 Forfeiture

Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

According to the Thai Penal Code, the court can order the forfeiture of a property that was used or possessed for use in the commission of an offence or acquired through the commission of an offence.

14 Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency system in your jurisdiction.

Under Thai law, bankruptcy is an involuntary act whereby the law causes the property of a company or debtor to be distributed among its creditors. Creditors may place a debtor in involuntary bankruptcy if the debtor is indebted to one or more plaintiff creditors for at least 1 million baht (in the case of a natural person), or 2 million baht (in the case of a juristic entity), and such debtor must be insolvent. Creditors have the right to receive repayment of the debt only when they file their claim with the receiver within the specified period.

In 1998, the Bankruptcy Act was amended to provide for restructuring or reorganisation of a company in a manner similar to the US Chapter 11 provisions. Automatic stay is recognised in the context of business restructuring or reorganisation. On the day the court makes an order accepting the petition for business reorganisation, an automatic stay also commences. The automatic stay prevents creditors from commencing or continuing lawsuits against the debtor, filing dissolution or bankruptcy petitions, enforcing payment of debt against the security asset (in the case of secured creditors) without the approval of the court, carrying out the execution of a judgment over the assets (in the case of judgment creditors), seizing or selling the debtor's assets, etc.

A lender cannot collect rent during a bankruptcy unless there has been a prior assignment of rent. However, such form of assignment is treated as a contractual obligation under Thai law. Therefore, the interest that an assignee has in an assigned property under an assignment agreement is not that of a secured creditor. The effect of an assignment is, subject to the limitations under bankruptcy laws (ie, cancellation of prior dispositions by a bankrupt), to transfer the rights and claims into the ownership of the assignee.

See question 42 with respect to the impact of bankruptcy on secured creditors.

Investment vehicles

15 Investment entities

What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

Investment can be made in limited companies, public limited companies, partnerships as well as mutual funds and other similar vehicles. Generally, companies and partnerships are subject to corporate income tax. Mutual funds, such as general mutual funds, infrastructure funds and real estate investment funds are pass-through entities for Thai corporate income tax purposes.

16 Foreign investors

What forms of entity do foreign investors customarily use in your jurisdiction?

Foreign investors customarily use private limited companies, as the shareholders' liability is limited to the amount invested (and any outstanding payment owing on shares).

17 Organisational formalities

What are the organisational formalities for creating the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

The formation of a private company is governed by the CCC. Registration at the Ministry of Commerce's department of business development proceeds as follows:

- name reservation;
- filing of memorandum of association;
- full subscription of shares;
- calling of a statutory meeting by the promoters to formally bring the company into existence;
- promoters hand over the business to the director(s); and
- the company is registered as a legal entity (or juristic person).

The registration of the incorporation of a limited company can be completed within one day provided that all documents have been properly signed by the promoters, directors and shareholders. A limited company has the obligation under the CCC to hold an annual general meeting within four months from the end of the fiscal period, and submit the financial statement within one month from the date of the AGM to the Ministry of Commerce every year. A company that fails to meet the deadline of the AGM of shareholders will be subject to a fine of up to 20,000 baht, and each of its directors will be subject to a fine of up to 50,000 baht. A company that fails to submit the audited financial statement within the deadline will be subject to a fine of up to 20,000 baht, and each of its directors will be subject to a fine of up to 50,000 baht.

Almost all common businesses (except for manufacturing and exporting) are reserved under the Foreign Business Act BE 2542 (1999). Foreign corporations and foreign majority-owned companies in Thailand may not engage in any reserved businesses unless they are granted either a foreign business licence or a foreign business certificate, or are otherwise exempted. Subject to confirmation from the Foreign Business Administration Division, the operation of businesses by foreigners without the aforementioned licence may result in penalties including imprisonment for a term not exceeding three years or a fine of 100,000 to 1 million baht, or both, and the court shall order the cessation of the business operation or the shareholding, as the case may be.

Only foreign majority-owned companies located in an industrial estate or that have received investment promotion from the Board of Investment may be allowed to own land for their business.

Companies and juristic partnerships organised under Thai law are subject to taxation on their worldwide income, both from Thailand and from foreign sources. Companies and juristic partnerships organised under foreign laws are subject to taxation only on income from sources within Thailand. A foreign company is deemed to be carrying on business in Thailand if it has an employee, representative or go-between in Thailand to carry out its affairs, and thereby derives income or gains there. Therefore a foreign company that establishes a branch office and derives income or gains therefrom in Thailand is deemed to be carrying on business in Thailand and thus is subject to corporate income tax for its branch office net profit. Wholly owned subsidiaries of foreign companies established as companies or juristic partnerships under Thai law are regarded as domestic entities, not foreign, and are subject to corporate income tax on worldwide income. Reduced rates at the progressive rates of 15 to 20 per cent with a tax exemption for the first 300,000 baht of the net profits are granted to qualified small and medium-sized enterprises.

Acquisitions and leases

18 Ownership and occupancy

Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

The categories of ownership and occupancy are:

- Freehold ownership: can be held perpetually and inherited by heirs or sold and transferred by the registered owner.
- Lease: regulated in Thailand under the rules for hire of property, and therefore not a real right such as a leasehold, as understood in common law jurisdictions, but a mere contractual tenancy right against payment of a rental fee. It needs to be registered on the title deed if the lease term exceeds three years and it cannot be inherited or transferred without the consent of the owner. The lease ends upon the death of the lessee.
- Usufruct: this is the right of a person (the usufructuary) to use, manage, and occupy land owned by another person, for a term of up to 30 years. It needs to be registered on the title deed and it cannot be inherited or transferred. Usufruct ends upon the death of the usufructuary.
- Superficies: this is the right of a person to own buildings, structures, or plantations upon or under the land owned by another person, for a term of up to 30 years. It needs to be registered on the title deed and it can be inherited, unless otherwise provided in the act creating it.
- Habitation: this is the right of a person to occupy another person's building as a dwelling place without having to pay rent, for a term of up to 30 years. It needs to be registered on the title deed and cannot be inherited or transferred.
- Servitude: this is a non-possessory right on land that usually involves two or more separate plots of land, one of which (called the servient property) is burdened while the other (called the dominant property) benefits from the servitude. Common examples of servitudes include using an access road over adjoining land plots or laying irrigation ditches, pipelines, or utilities over neighbouring plots. A servitude must be registered on the title deed and extinguishes in the case of non-usage for 10 years or by total destruction of the dominant or servient property.

All the above-mentioned interests can only be created by being registered in one of the following land title documents:

- Nor Sor 4 Jor (also called Chanod), which is the only land title deed certificate granting full private ownership of land. The land can be subdivided and there are no general restrictions. The exact boundaries of land under a Chanod title have been accurately surveyed and plotted by GPS.
- Nor Sor 3, which is not a full ownership title deed, but only certifies a right of possession. The land boundaries under a Nor Sor 3 have not been accurately surveyed yet. Once they have been surveyed, the document will be called a Nor Sor 3 Gor or Nor Sor 3 Khor.

There are a multitude of other land documents and certificates issued by the Land Office or other government offices, but they cannot be used for registration of any benefits or encumbrances on real estate.

19 Pre-contract

Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

It is not customary for parties to execute a form of non-binding agreement, such as a letter of intent, before the execution of a binding contract of sale in transactions of smaller values and where terms are less complicated. Under Thai law, as long as the parties have not agreed upon all points of a contract upon which, according to the declaration of even one party, agreement is essential, the contract is, in the event of doubt, not concluded. In addition, an understanding concerning particular points is not binding, even if it has been noted down.

20 Contract of sale

What are typical provisions in a contract of sale?

A contract of sale typically contains the following provisions:

- definition of property;
- payment terms;
- representations and warranties of the seller;
- title transfer date; and
- liability for transfer fees and taxes.

The typical down payment is 10 to 20 per cent of the purchase price. An escrow arrangement is not common. Good title is evidenced by a copy of the title document certified by the Land Office. Title search is generally done by the purchaser at his or her cost, unless the seller agrees otherwise.

Typical general representations and warranties given by the seller are:

- the seller's valid title to the property;
- that the property is clear from all forms of encumbrances, such as mortgages, security interests, claims, charges, liens, leases, tenancies, licences or other rights of occupation, options or other agreements affecting the same; and
- that no investigation, action, suit or proceedings are pending before any court or by any governmental body that seeks to restrain, prohibit or otherwise challenge the sale of the property.

Unless otherwise agreed, parties shall be equally responsible for the transfer fees and stamp duties. All other taxes are to the account of the seller, but the burden may be passed on to the buyer by contract.

21 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

Under the Enhancement and Conservation of National Environmental Quality Act 1992, the owner or possessor of the point source of leakage or contamination causing death, bodily harm or injury to any person or damage in any manner to the property of any private person or of the state shall be liable to pay compensation or damages. This liability exists regardless of whether such leakage or contamination is the result of a wilful or negligent act of the owner or possessor. Exceptions to this liability are available if it can be proved that such pollution leakage or contamination is the result of:

- force majeure or war;
- an act undertaken in compliance with an order of the government or state authorities; or
- an act or omission of the person who sustains injury or damage, or of any third party who is directly or indirectly responsible for the leakage or contamination.

The compensation or damages to which the owner or possessor of the point source of pollution shall be liable include all the expenses actually incurred by the government service for the clean-up of pollution arising from the incident.

Typical seller's covenants would include warranties for compliance with environmental laws and absence of claims, and indemnities against breach thereof. Typical buyer's covenants would be compliance with environmental laws and indemnities thereof for claims against the seller. Remedies for breach would be typical claims for contractual breach (ie, court action and claims for damages).

22 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

The law stipulates that a lease over an immoveable property is not extinguished by the transfer of ownership of the property hired. The transferee is entitled to the rights and subject to the duties of the

transferor towards the tenant. Typical covenants made by sellers of property with existing leases would be indemnities against defaults, no renewal or amendment of the current lease without the consent of the buyer, no third-party liability, such as brokerage fees, etc. Estoppel certificates from tenants are not customarily required.

23 Leases and real estate security instruments

Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

At foreclosure, the mortgagee has priority over the mortgaged property. If the lease was registered with the consent of the mortgagee, it shall not be extinguished by the transfer of ownership arising from enforcement of the mortgage. However, if the lease was registered after the registration of the mortgage without the consent of the mortgagee, the mortgage has priority over the lease and such lease will be erased from the register where its existence prejudices the right of the mortgagee on the enforcement of the mortgage. Lenders typically require conditional assignment of lease from a borrower who is a lessee, conditional assignment of rental from a borrower who is a lessor, or both. Ground (or head) leases are not treated differently from other commercial leases in this regard.

24 Delivery of security deposits

What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

Security deposits are common in the form of cash. Leases customarily have periodic rent reviews.

25 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain a zoning report or legal opinion regarding legal use and occupancy?

Title insurance and legal opinion letters are not common. Recently, however, title searches conducted by lawyers on behalf of buyers or by buyers themselves have become commonplace, especially with respect to transactions of larger value. Typical methods of title searches include examination of land documents at the relevant land office, bankruptcy searches, searches at the Legal Execution Office and relevant courts and corporate searches (in cases where the owner is a corporate entity).

Interests registered first have priority. The priority among interests can only be reordered by registration, not by mere contract between the parties.

In general, the zoning report containing restrictions on the use of the land should be obtained.

26 Structural and environmental reviews

Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

Because of the costs involved, an engineering and environmental review would usually be arranged only with respect to larger transactions and property development projects. It is customary to get representations or an indemnity. Environmental insurance is not common. A zoning report or legal opinion is advisable, although this is typically arranged only in relation to new development projects or where the buyer intends to build new structures or have specific purposes for the property.

27 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

Leases are usually reviewed by lawyers as well as on the business side. Where the clients are the lessees, the following is generally pointed out:

- leases of more than three years are enforceable only for three years, unless they are made in writing and registered with the competent authorities;
- any increase in rentals may be capped;
- it is the lessor's liability to pay land and house tax (12.5 per cent of the annual rental) and any other income-related taxes and stamp duties;
- ownership of constructions and other improvements over the leased property;
- free rent during the fitting-out period; and
- lessee's termination rights without penalty in certain circumstances.

Whether lenders require management agreements to be subordinate to financing security instruments will depend on a number of factors, such as the creditworthiness of the borrower and the quality of the overall security package.

28 Other agreements

What other agreements does a lawyer customarily review?

Other agreements and documents usually reviewed by lawyers are:

- service agreements and other ancillary agreements, as it is customary for lessors to divide the lease into lease of premises and service and agreement for tax reasons;
- title documents; and
- rules and regulations where the leased premises are in a building or a property development.

29 Closing preparations

How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

The list of deliverables at closing would principally include:

- executed agreement and ancillary documents;
- the parties' authorisations, corporate documents and personal identification, where relevant;
- copies of title documents; and
- keys and access cards to the premises.

In the case of a financed ordinary lease, the financing source would typically require conditional assignment of the lease and the landlord's consent thereof, valid insurance over the leased property with the financing source named as a beneficiary and assignment of rental in the event that the lessee subleases the leased premises. If the lease period exceeds three years, the lease must be registered with the competent Land Department.

In the case of a financed purchase of property or a financed lease under the Act Governing Leasing of Immoveable Property for Commercial and Industrial Purposes, the financing source would typically be required to have been registered as the mortgagee on the land title deed.

The timing between the contract and closing varies widely and depends on the circumstances, but usually takes around three to six months. The timing of the closing and the funding is usually simultaneous.

30 Closing formalities

Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

The closing is done in person with all parties present, or by their representatives who are authorised by power of attorney, and are present at the competent land office. The transaction must be registered in the title deed by the land officer, after he or she has obtained the executed

official form agreement of the transaction (eg, sale or lease agreement) and the required fees and taxes.

31 Contract breach

What are the remedies for breach of a contract to sell or finance real estate?

The remedies for a breach of a real estate sales or financing contract depend mainly on the content of the contract. In real estate sales contracts, it is common for any deposits made by the buyer to be forfeited and the contract terminated if the purchaser does not remedy his or her breach within a certain period of time. Purchasers or sellers are able to make a claim for damages against the defaulting party, but must sue in court and obtain a judgment first. The contract cannot be specifically enforced without a prior judgment by the competent court.

32 Breach of lease terms

What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply?

The tenant can demand reimbursement of reasonable expenses incurred for necessary repairs, or terminate the lease contract if the property is not in a condition suitable for the purpose it was hired for.

If the tenant uses the property for purposes that are not provided for in the contract, or fails to take the necessary care in the ordinary maintenance or the petty repairs of the property, the landlord may notify the tenant, and, in the case of non-compliance, terminate the contract. The same applies in the case of the tenant failing to pay the rental fee after having been put on notice to do so.

In enforcing the rights of eviction, a civil case needs to be instituted. In such an event, the provisions of the Civil Procedure Code of Thailand shall apply. If the judgment debtor (ie, the tenant as possessor of the property) fails to comply with an eviction order, the judgment creditor is entitled to file an ex parte application to the court for an order appointing the executing officer to procure the judgment creditor to take possession of the property. The court has the power to order the arrest and detention of the judgment debtor, entrust the whole or part of the property to the judgment creditor, and, where necessary, allow the obstructive matters that prevent possession to be destroyed.

Land eviction can be a time-consuming process, as it involves lengthy court proceedings, and it may take more than a year to complete.

The specific contract rules of the CCC about hire of property apply to a lease of immoveable property.

Financing

33 Secured lending

Discuss the types of real estate security instruments available to lenders in your jurisdiction.

In Thailand, mortgages are used to create a lien on real estate to secure indebtedness. The mortgagor assigns a property to the mortgagee as security for the performance of an obligation without delivering the property to the mortgagee. The mortgagor may also mortgage his or her property as security for the performance of an obligation by another person.

34 Leasehold financing

Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

Financing for ground (or head) leases is available in Thailand, depending on the disposition of the financial institutions. The difference between financing for land ownership transactions and financing for leases is that in the case of a land ownership transaction, a mortgage on the land can be registered as the collateral, whereas for a lease, the right to lease can only be used as a security if the lease is registered under the Act Governing Leasing of Immoveable Property for Commercial and Industrial Purposes. For ordinary leases that do not fall under this act, only the assignment of the lease can be used as collateral. There is no minimum term for a lease being financed, nor is there a shorter maximum term for the financing in relation to such a lease being mandated by law.

35 Form of security

What is the method of creating and perfecting a security interest in real estate?

Security interest in immoveable property is limited to the mortgage under Thai law. A mortgage is created by contract whereby the mortgagor assigns a property to the mortgagee as security for the performance of an obligation without delivering the property to the mortgagee. A contract of mortgage must be made in writing and registered by the competent official.

A mortgage over land does not extend to the buildings. The mortgagee may sell the buildings with the land but can exercise his or her preferential right only against the price obtained for the land. A mortgage over buildings erected or constructions made upon or under the land of another person does not extend to such land, and vice versa.

36 Valuation

Are third-party real estate appraisals required by lenders for their underwriting of loans? Must appraisers have specific qualifications?

Third-party real estate appraisals are required by lenders if the size and expected value of the property is great enough to justify such a requirement. It is recommend to use appraisers that are licensed by the Securities Exchange Commission or are certified by a professional organisation such as the Valuers Association of Thailand, the Thai Valuers Association or the Royal Institution of Chartered Surveyors.

37 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

A foreign person, natural or juristic, is qualified to make a loan secured by collateral in Thailand without having to qualify to do business in Thailand. Any of the forms of security may be created in favour of the foreign person. With respect to a juristic person mortgagee, the land office would require that the mortgagee be permitted under its constitutional documents to take mortgage over the land as security for the loan.

To be valid and enforceable under the law, a mortgage must be in writing and registered with the relevant authorities (ie, the land office). The registration fee is 1 per cent of the amount of mortgage up to the maximum amount of 200,000 baht. There is no such maximum amount for mortgage of a condominium unit. Stamp duty is also levied at the rate of 1 baht for every 2,000 baht up to a maximum of 10,000 baht. Mortgages are transferable by way of registration at the land office and payment of the registration fee and stamp duty as mentioned above.

38 Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

The maximum rate of interest chargeable by the international financial institutions of which Thailand is a member, banks or financial institutions registered and located in foreign countries, is currently 20 per cent per year. The maximum rate of interest chargeable by other persons and entities is 15 per cent per year. In the event that the interest rate applicable under an agreement exceeds the maximum rate of interest permissible under Thai law, all interest accrued but unpaid may not be recoverable by the lender. Payment of fees, expenses, charges and penalties payable to the lender may be reclassified as income similar to

Update and trends

In August 2015, the Business Collateral Act was approved covering a broader range of assets that could be used as security. A new type of contract called a business collateral contract will be introduced under the act. The security provider grants security over property for the performance of an obligation to the security receiver. The security provider stays in possession of the collateral and is entitled to use, exchange, dispose, transfer and mortgage the asset that is collateral. The types of collateral include, inter alia, moveable property, intellectual property, a business and a claim. The security provider can be an individual or a financial institution, whereas the security receiver has to be a financial institution or any other person under the act. The business collateral contract has to be in writing and to be registered with a competent officer. Implementing regulations, for example regarding the secured assets list and registration procedure, are required before the Business Collateral Act becomes effective. The associated amendment to the Civil and Commercial Code awaits royal assent and announcement in the *Royal Gazette*.

the interest on a loan and therefore may be subject to the withholding tax. Offshore loans typically set interest rates in reference to international interest rates indices. Local interest rates are set in reference to the minimum lending rate (MLR) of a specific bank or the average MLR of a number of local banks.

39 Loan default and enforcement

How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

To enforce a mortgage, the mortgagee must notify the debtor in writing to perform his or her obligation within a reasonable amount of time, which must not be less than 60 days from the date the debtor has received such notice. If the debtor fails to comply with such notice, the mortgagee may take court action to request a judgment ordering the mortgaged property to be seized and sold by public auction.

Special rules apply if the mortgagor has mortgaged his or her own property as security for the performance of an obligation by another person. In that case, the mortgagee must send the said notice to the mortgagor within 15 days of the date of sending the notice to the debtor. If the mortgagee does not take any action within the 15-day period, the mortgagor shall be discharged of the liability on interest and compensation owed by the debtor, together with encumbrances that are accessories of the said debt, all of which occur from the lapse of the 15-day period.

For enforcement of the mortgage, the mortgagee is entitled to claim foreclosure, if there are no other encumbrances on the same property, under the following conditions in lieu of sale by public auction:

- the debtor has failed to pay interest for five years; and
- the mortgagor has satisfied the court that the value of the property is less than the amount due.

In addition to the above, public sale of the mortgaged property can also be achieved without taking an action in court. The mortgagor is entitled to send a notice to the mortgagee at any time after the debt is due to proceed with the sale by public auction (if there are no registered mortgages or preferential rights on the same property). The mortgagor's notice serves as a letter of consent for sale by public auction. The mortgagee shall then proceed with the sale by public auction within one year of the date of receipt of such notice. If the mortgagee fails to do so, the mortgagor shall be discharged of the liability on interest and compensation owed by the debtor, together with encumbrances that are accessories of the said debt, all of which occur from the lapse of the said period.

As foreclosure is rather cumbersome, it is rarely resorted to. In most cases, a mortgage is enforced by filing a case in court and obtaining a court judgment for sale of the mortgaged property by public auction. Enforcement through a judicial procedure is treated as any civil litigation and could take one to three years at first instance.

40 Loan deficiency claims

Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

Unless otherwise agreed by the parties in the mortgage agreement, if the estimated value of the property (in the case of foreclosure) or the net proceeds (in the case of auction) are less than the amount due, the borrower is not liable for the difference. The time limit for a lender seeking a deficiency judgment is 10 years.

The mortgagor who has mortgaged his or her property as security for the performance of an obligation by another person is not liable to the obligation exceeding the value of the mortgaged property. Any agreement to the contrary is invalid. However, this rule does not apply in the case where the primary debtor is a juristic person and the mortgagor has managerial power to control the operations of the primary debtor, and the mortgagor has guaranteed the primary debtor a debt in a separate suretyship agreement.

41 Protection of collateral

What actions can a lender take to protect its collateral until it has possession of the property?

Thai law does not recognise the concept of mortgagee in possession.

42 Recourse

May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

In a mortgage, if the estimated value of the property (in cases of foreclosure) or the net proceeds (in cases of auction) are less than the amount due, the debtor of the obligation is not liable for the difference. In this respect, the mortgage agreement must specify that in the event of enforcement of the mortgage, if the net proceeds realised from the sale by public auction of the mortgaged property are less than the outstanding amount payable by the mortgagor, the mortgagor shall, until all such amounts shall have been actually paid in full to the mortgagee, remain liable to promptly pay the deficient amount to the mortgagee. However, this does not apply to the mortgagor who has mortgaged his or her property for the performance of an obligation by another person (see question 40). With respect to pledge, the law stipulates that in the event of enforcement, if the proceeds are less than the amount due, the debtor remains liable for the difference. In the context of bankruptcy, a secured creditor may file a claim for repayment of the debt on the following conditions:

- when he or she agrees to surrender the asset afforded as security for the benefit of all creditors, he or she may claim for the full amount of debt;
- after he or she has already enforced his or her claim against the asset given as security, he or she can claim for the balance of the remaining unpaid debt;
- when he or she has asked the receiver to sell by public auction the secured assets, he or she can claim for the balance of the debt remaining unpaid; and
- when he or she has appraised the secured asset, he or she can claim for the balance remaining unpaid.

43 Cash management and reserves

Is it typical to require a cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

Lending banks typically require borrowers to maintain certain accounts for various purposes into which all monies, revenues and receipts received or recovered by the borrower must be deposited and distribution of which shall be according to an order of priority specified by the bank.

44 Credit enhancements

What other types of credit enhancements are common? What about forms of guarantee?

In a real estate transaction, letters of credit are not common. Holdbacks and guarantees may be required with respect to construction defects or environmental problems, or in an extended closing. Payment guarantees may be required but sellers would generally prefer escrow arrangements. In smaller value transactions, sellers would generally have security in the form of deposit, instalment payments and contractual provisions of forfeiture of such payments in the event closing does not occur. A guarantor is able to guarantee a valid and existing obligation of the primary debtor. If the guarantor would like to specifically limit its guarantee, where the debtor has engaged in certain proscribed acts, the parties are free to stipulate this in their agreement.

45 Loan covenants

What covenants are commonly required by the lender in loan documents?

Loan covenants typically follow international practice and include proper authorisations, compliance with laws, pari passu ranking, negative pledge regarding creation of security interest over any of the borrower's assets, not to incur any financial indebtedness subordination of connected party loan, no change of business, no merger or acquisition, payment of taxes, maintaining certain accounts, etc. Covenants usually do not vary much, but this depends on the asset class. With respect to leasehold financing, the loan documents would not contain a valid title covenant, but would probably include a covenant that grants the borrower the legal right to access, use and possess the leasehold property.

46 Financial covenants

What are typical financial covenants required by lenders?

Financial covenants typically follow international practice and include debt-service coverage ratios, gearing ratios, financial reporting requirements and ongoing periodic or on-demand appraisals.

47 Secured moveable (personal) property

What are the requirements for creation and perfection of a security interest in moveable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

Security interest on non-real property is limited to pledge or mortgage of certain types of machinery and vessels. Pledge requires delivery of the pledged property to the pledgee or a third party agreed by a custodian. If the pledged property is a right, it has to be represented by a written instrument that has to be delivered to the pledgee and the pledge has to be notified in writing to the debtor of the right. Where the pledged property is a share in a company, recordation of such pledge in the share registry of the company is required. A mortgage requires registration with the competent authority.

48 Single purpose entity (SPE)

Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

It is not typical for lenders to require that each borrower be an SPE. An SPE is typically established as a private limited company. There is no concept of an independent director of SPEs formed as a private limited company in Thailand.

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General

1 Legal system

How would you explain your jurisdiction's legal system to an investor?

The United Arab Emirates (UAE) is a federation of seven emirates comprising Dubai, Abu Dhabi, Ajman, Fujairah, Ras Al Khaimah, Sharjah and Umm Al Quwain. It is based on the civil law system derived from shariah law and influenced by Egyptian laws and jurisprudence.

The UAE federal constitution provides for an allocation of powers between the federal government and the government of each emirate and grants each emirate the right to make its own laws relating to real estate. Currently, all the emirates except Fujairah have their own real estate laws and regulations.

The UAE Constitution allows emirates to opt out of the federal judicial system. Therefore, an emirate may opt out and set up its own independent judicial system. Presently, Dubai and Ras Al Khaimah have their own independent judicial systems in place whereas the other emirates continue to be a part of the federal judicial system.

Further, in Dubai, the Dubai International Financial Centre (DIFC) has been set up as an independent body having its own set of laws based on the common law system and an independent judicial system. The recent trend has been that of DIFC courts expanding their jurisdiction as parties can choose DIFC courts for dispute resolution by subjecting themselves to their jurisdiction.

In the UAE, although preventive relief in the form of attachment of property can be obtained, injunctive relief is not usually granted by the courts.

Common law principles, such as equity or 'just law' or adopting previous court judgments as legal precedents, are generally not recognised in the UAE. However, judgments of the Federal Supreme Court and the Courts of Cassation do have a strong persuasive value in cases where a substantial question of law is to be determined.

In principle, the parol evidence rule holds good in the UAE and its application can be found in Federal Law No. 10 of 1992 on the Issuance of the Evidence Act for Civil and Commercial Transactions. However, in practice courts do look into circumstantial evidence, and hence this rule is not strictly applied in this jurisdiction.

In the UAE, parties are free to enter into oral agreements subject to the provisions of the law. UAE law relating to contracts recognises that binding and enforceable agreements can be concluded orally or in writing. However, oral contracts are difficult to prove in courts and therefore, written agreements remain predominant in this jurisdiction.

2 Land records

Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

In the UAE, all emirates have their own system of registration for real property except Fujairah wherein there are no specific laws regarding property registration and ownership. The provisions of the Federal Law No. 5 of 1985 (the UAE Civil Code), therefore continue to regulate the real estate sector in Fujairah. Other emirates have their own land departments regulating registration of real property and interests in real estate. Certain emirates like Dubai and Ajman have also set up special bodies such as the Real Estate Regulatory Authority (RERA) in Dubai and the Ajman Real estate Regulatory Authority (ARRA) in Ajman to regulate the real estate sector.

In the emirate of Dubai, all real estate transactions need to be registered with the Dubai Land Department (DLD). As per Law No. 7 of 2006 concerning Real Property Registration in the Emirate of Dubai, a real property register is maintained at the DLD to record all real property rights. Further, in the case of off-plan sales or any disposition that occurs with respect to an off-plan real estate unit, registration is mandatory in the Interim Property Register as per Law No. 13 of 2008 regulating the Interim Property Register in the Emirate of Dubai.

In the UAE, a security interest is created over real property by way of a mortgage. In order to be valid, the UAE Civil Code requires a mortgage over real property to be registered (see also question 35).

3 Registration and recording

What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

The legal requirements for registration of real property and security interests vary from emirate to emirate in the UAE.

For instance, in the emirate of Dubai, the DLD maintains a real property register wherein freehold or leasehold interests and mortgages over them must be recorded. In order to register an interest in real property in Dubai, the applicant must submit to the DLD: the title deed, the contract or lease creating the interest, the prescribed form or forms and the transfer fee.

In the case the applicant is an entity, the constitutional documents of the entity along with certificate of good standing and incumbency may need to be submitted additionally depending on the legal requirements of each emirate.

In the case of registration of security interests over real property, a mortgage over real property can only be registered in favour of banks and financial institutions licensed by the Central Bank of the UAE. A mortgage is generally recorded using a standard form mortgage agreement prescribed by the land department of the respective emirate, which must be signed by the mortgagor and mortgagee.

Generally, for registration of real property, an investor has to pay land registration or transfer fee as prescribed by the land department of the respective emirate and may also incur legal fees and fees to be paid to the developer or real estate agent.

For instance, in Dubai, land registration or transfer fee for the DLD is currently 4 per cent of the value of the real property. This transfer fee is shared proportionately between the seller and the purchaser or as mutually agreed between the parties in the contract.

There are various ways to minimise or reduce the amount of fees payable to the land departments or fees otherwise associated with registration on a case-by-case basis.

4 Foreign owners and tenants

What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

Laws regarding ownership of land by foreign nationals differ from emirate to emirate in the UAE.

In the emirate of Dubai, foreign nationals are allowed to own freehold title in particular areas that have been designated for foreign ownership and called 'Designated Areas'. Foreign nationals can also take a long lease or usufruct right up to 99 years in real property in certain Designated Areas in Dubai, which are listed in Regulation No. 3 of 2006 (as amended by Regulation No. 1 of 2010).

In Dubai, the only types of offshore companies that are permitted to own property in the Designated Areas are companies incorporated in the Jebel Ali Free Zone (JAFZA Offshore).

As per the current circulars and regulations, companies incorporated in the free zones in Dubai are allowed to own properties in the Designated Areas. However, free zone companies incorporated in other emirates are not allowed to own properties in Dubai.

In order for entities to carry out business in Dubai, they must obtain the relevant commercial or professional business licence from the Department of Economic Development and they may also be required to obtain certain other approvals or clearances based on the activities proposed to be undertaken. These requirements also differ from emirate to emirate.

In the emirate of Abu Dhabi, previously only UAE and Gulf Cooperation Council (GCC) nationals were permitted to own freehold property. However, the emirate has now issued a resolution to register ownership and issue title deeds to foreign investors as well. Foreign nationals are also allowed to hold, in certain designated investment zones, a 99-year lease or own apartments without the right to ownership of the land.

In the emirate of Sharjah, initially only UAE nationals were allowed to own real property. However, the Sharjah Executive Council recently issued Resolution No. 26 of 2014, which allows foreign nationals to hold properties in Sharjah for up to 100 years provided they are UAE residents.

Hence, an investor must look into the real estate laws and regulations of the respective emirate before making an investment into real property located within the emirate. Further, while purchasing off-plan units in projects, it is advisable to ensure that the developer and the project are registered with the respective land department of the emirate.

5 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

There are no foreign exchange controls, trade quotas or barriers that exist in the UAE, and 100 per cent repatriation of capital and profits is permitted.

6 Legal liability

What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

The extent of liability faced by a developer, owner, tenant or lender of real property in the UAE varies from emirate to emirate based on the real estate laws of the particular emirate in question.

For example, in the emirate of Dubai, the strata law was enacted in 2007, which provides ownership for jointly owned real property in Dubai. According to the strata law, the owner of a unit is under a continuous obligation to pay the service charges or maintenance fee in order to maintain the real property and common areas. The owners' association has an obligation to manage and maintain the real property on behalf of the owners and also has the right to institute legal proceedings against unit owners defaulting on payment of service charges. Further, the developer of real property is under liability for 10 years from the date of completion of the property to repair or remedy any structural or stability defects in the real property.

In respect of liability of a tenant, as a matter of practice, most tenancy contracts in the UAE do not allow for subleasing. In Dubai, tenants must register their tenancy contracts, and usually tenants are also responsible for paying for all utilities and amenities. General standard obligations such as payment of security deposits, handover of the unit in a good state of repair apart from usual wear and tear and refraining from permitting or carrying out any illegal or immoral activities within the property remain in force in the UAE as well.

The area of tortious liability is not very well developed in the UAE. However, the UAE Civil Code provides that, in all cases, a party will remain liable for its own gross negligence or fraud, or both. Therefore, in such cases courts are unlikely to allow any party to rely on an indemnity provision.

7 Protection against liability

How can owners protect themselves from liability and what types of insurance can they obtain?

In the UAE, owners can protect themselves from liability by taking various types of insurance, such as building insurance, fire insurance, insurance from theft, insurance from loss of rent, contents insurance and third-party liability insurance.

8 Choice of law

How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

UAE law recognises the principle of freedom of contract, and therefore parties are free to agree upon a foreign law to govern their contract.

However, in the case of real estate, all transactions in the UAE are subject to the UAE federal laws and the laws of the emirate in which the real property is located.

Further, in respect of real property located in DIFC, the DIFC real estate laws and regulations will apply.

9 Jurisdiction

Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

The UAE federal courts have jurisdiction to determine real estate disputes. Further, since emirates like Dubai and Ras Al Khaimah have their own independent court system (see question 1), the courts in these emirates have jurisdiction over matters arising within the respective emirates.

Parties to a contract may also mutually agree to refer any future disputes to the jurisdiction of any arbitration centre such as the Dubai International Arbitration Centre (DIAC), the Abu Dhabi Commercial Conciliation and Arbitration Centre or the Ajman Centre for Commercial Conciliation and Arbitration.

Further, the DIFC, having an independent legal system with its own DIFC courts and the DIFC London Court of International Arbitration (LCIA) Arbitration Centre, also has jurisdiction over real estate matters in certain cases (see question 1).

Besides the above, different emirates have their own committees or authorities having jurisdiction over certain real estate matters. For instance, in Dubai, the committee for the liquidation of cancelled real estate projects and settlement of rights related thereof has jurisdiction in the liquidation of cancelled real estate projects in Dubai. Also, the DLD launched a programme called Tanmia, which looks after incomplete projects in difficulty and real estate projects that are not progressing. Tanmia aims to play the role of a mediator between developers of such projects and investors, with settlement and negotiation being the preferred approach.

The Rent Dispute Settlement Centre in the emirate of Dubai looks into rental disputes between landlords and tenants.

10 Commercial versus residential property

How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

In the UAE, most the of federal and local laws pertaining to real estate on the matters of ownership, financing or security over real property are similar for both commercial and residential properties and apply to all developments including mixed-use developments. (See also question 18.)

11 Planning and land use

How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

The Planning and Survey Departments of the respective municipalities in each emirate control and oversee planning and development of real estate, construction and land use.

For instance, in the emirates of Abu Dhabi and Dubai, the Abu Dhabi Municipality and Dubai Municipality oversee development, building regulations and planning controls in their respective emirates.

Also, the Department of Planning and Development – Trakhees – has been established in Dubai to undertake supervision of engineering, issuance of building permits, commercial licensing and supervision of all health, safety and environment matters within the free zones in Dubai.

Buildings constructed within an investment area, a freehold area or a free zone in any emirate may also be subject to the regulations and controls of the master developer or regulatory authority for that area such as the RERA for the emirate of Dubai.

12 Government appropriation of real estate

Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

There are no express regulations in place in the UAE whereby the government can appropriate real estate or exercise compulsory purchase of real estate. However, the government may acquire real estate compulsorily on grounds of public policy. To our knowledge, the government has not acquired any real estate on these grounds to date.

13 Forfeiture

Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

In the UAE, the law does not contain provisions wherein the government could forfeit or seize real estate privately owned by an individual or an entity. In cases where illegal activities are carried out, the dispute will be determined in the court having appropriate jurisdiction, and the property will then be dealt with accordingly. (See also question 12.)

14 Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency system in your jurisdiction.

In the UAE, the provisions governing bankruptcy and insolvency of individuals as well as commercial entities are found in the Commercial Transactions Law, Federal Law No. 18 of 1993.

Under the Federal Law, a trader may voluntarily file for a declaration of bankruptcy if it is not able to pay its debts due to financial instability. A trader is any individual or company that conducts commercial activities in the UAE. A trader must file for a declaration of bankruptcy if 30 days lapse from the date on which it first ceases to pay its debts. Failure by the trader to do so will be construed as committing 'negligent bankruptcy', which is a criminal offence under the UAE Penal Code, Federal Law No. 3 of 1987.

Bankruptcy can be initiated by a trader, a public prosecutor, a court or the trader's creditors. The creditor may also negotiate a composition or scheme of settlement with the trader to recover a proportion of the debt owed. After a bankruptcy application is submitted, the court must take all necessary steps to preserve and protect the trader's assets. Once the court declares bankruptcy, liquidation proceedings follow.

In the emirate of Dubai, according to Law No. 33 of 2008, outstanding rent payable by a tenant to the landlord is a ground for eviction. Also, a typical lease enables the landlord to terminate the lease if the tenant becomes insolvent. However, this is not set out expressly as one of the grounds of eviction under the laws.

Further, according to the UAE Civil Code, a company ceases to exist on insolvency. However, the company retains its legal personality until liquidation of its assets. The UAE Commercial Transactions Law provides that if the assets of the company are insufficient to satisfy at least 20 per cent of its debts, the directors can be ordered personally to pay the debts of the company.

Investment vehicles

15 Investment entities

What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

All emirates within the UAE have different laws and regulations with respect to investment by local or foreign entities in real estate.

For instance, in the emirate of Dubai, UAE nationals, GCC nationals and companies incorporated onshore in the UAE (except free zones) that are 100 per cent owned by UAE or GCC nationals can invest in real estate in all areas of Dubai.

However, foreign nationals, free zone companies incorporated in Dubai, Jebel Ali Free Zone offshore (JAFZA offshore) companies, Dubai Multi Commodities Centre Free Zone offshore (DMCC offshore) companies and companies incorporated onshore in Dubai, such as limited liability companies, can invest in real estate only in the Designated Areas.

Further, DIFC special purpose companies, being private companies limited by shares and incorporated under the laws of DIFC, have no foreign ownership restrictions for investment in real estate.

Also, the passage of the DIFC Investment Trust Law has created real estate investment trusts for the specific purpose of investment in real estate in the DIFC.

As the UAE is a tax-free jurisdiction, tax provisions do not apply in any of the emirates, and none of the entities are liable to tax. However, free zone entities are guaranteed tax-free benefits by the respective governments in the UAE.

16 Foreign investors

What forms of entity do foreign investors customarily use in your jurisdiction?

The legal form of an entity for the purpose of foreign investment in the real estate sector in UAE would depend upon the emirate in which the investor would want to invest.

Dubai and Abu Dhabi are real estate investment hubs in the UAE. Generally, the most favourable and preferred legal form for investment in the real estate sector in Dubai by a foreign investor is an offshore company, particularly a JAFZA offshore. This is primarily due to 100 per cent ownership and control over the entity and the ability to acquire real estate in designated areas in Dubai.

17 Organisational formalities

What are the organisational formalities for creating the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

Organisational formalities to create a legal entity would differ based on the type of legal entity sought to be formed and the emirate chosen for the same.

For instance, in order to set up a limited liability company in the emirate of Dubai, the formalities and the requirements of the Department of Economic Development (DED) have to be followed based on the business activity proposed to be carried out by the company. For example, having a registered commercial lease is a prerequisite of the DED for a limited liability company to carry out business activities in Dubai. Failure to comply with such requirements would result in heavy fines or other penalties. In the case of setting up a JAFZA offshore, the Jebel Ali Free Zone Authority lays down the guidelines and requirements for setting up a company.

With due assistance from lawyers, the process of setting up a legal entity in Dubai can be completed easily, without any hassles and generally within four to six weeks.

The UAE is a tax-free jurisdiction, and hence none of the legal entities are subject to any tax consequences. However, legal entities formed in the free zones are entitled to certain additional benefits and tax-free guarantees given by the respective free zone authority.

Acquisitions and leases

18 Ownership and occupancy

Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

The UAE Civil Code provides for the following interests in real property:

- freehold ownership: this is the most common form of ownership wherein the owner has title to the land or property and also possesses the right to use, occupy and enjoy the property or land in perpetuity;
- *musatahah*: this is a right to use the land and to construct buildings thereon for a limited period of time not exceeding 50 years. The holder of a *musatahah* right is deemed to own all the buildings on the land for the specified duration. The property register contains details of all *musatahah* right-holders; and
- usufruct or leasehold: this is the right to use, occupy and enjoy the land or property for a limited period of time without the right of ownership. The title remains vested with the ultimate owner of the property with only the rights of use and enjoyment passing on to the lessee. The term of the lease is fixed and cannot exceed 99 years.

Under the UAE Law, there are several types of easements that may burden the land such as the easement of right of way, right to draw water, rights of passage of water, etc. The UAE Civil Code provides that easements may be created by consent, legal disposition or inheritance, but the rights must be defined in the document where they are created and by the prevailing custom.

19 Pre-contract

Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

In the UAE, a non-binding agreement or contract is not enforceable. It is customary to enter into a memorandum of understanding or a reservation contract prior to entering into a detailed sale and purchase agreement in real estate transactions. Typically, reservation contracts are like booking forms wherein the purchaser or investor pays a non-refundable deposit towards the purchase price of the property to reserve it. Thereafter a sale and purchase agreement is executed by the parties. These reservation contracts are binding and enforceable at law, thus exposing the parties to liability in the event of breach or non-performance. Negotiation before entering into binding agreements is a customary process and typically takes several weeks before the transaction is completed.

20 Contract of sale

What are typical provisions in a contract of sale?

The sale and purchase agreement or the contract of sale for transactions of real estate generally details the contracting parties, the property, the purchase price, payment schedule, the amount of deposit (if any), the term of the agreement, provision on the payment of the transfer fee at the land department and other terms and conditions of the transaction as agreed between the parties to the contract. The contract becomes legally binding once it is executed by all the parties involved.

In the contract of sale, the seller typically warrants that the property is free of encumbrances and he or she holds good title to the property; he or she is authorised to sell the property; the property is free of third party interests; and all outstanding debts and service charges are fully paid up until the date of the transfer of property.

It is noteworthy that, in the emirate of Dubai, the DLD introduced unified real estate contracts in 2014, which must be used in all real estate transactions. However, additional terms and conditions are required in many transactions. Hence, generally, a detailed contract negotiated between the parties supplements the unified real estate contract.

Further, as per Law No. 8 of 2007 concerning Escrow Accounts for Real Estate Development in the Emirate of Dubai, it is mandatory to have an escrow account for all units sold off-plan in real estate development projects in the emirate of Dubai.

21 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

In the UAE, environmental law comprises federal and local laws. Federal Law No. 24 of 1999 for the Protection and Development of the Environment sets out the liability and penalties for violating environmental provisions. If a party intentionally or by negligence breaches the provisions of any environmental laws, the party will be held liable for clean-up costs and compensation for any damage caused to the environment or any individuals.

Further, since environmental liabilities may pass with ownership of land, a purchaser of land should include appropriate warranties from the seller in contract of sale and consider whether physical inspection and testing of the land should be carried out.

22 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

Generally, the purchaser is under an obligation to make legal due diligence checks and investigations on the property being purchased. In the case of an existing lease, typical representations made by a seller would include details regarding the security deposit paid by the tenant, whether rents have been duly paid, any dues that are outstanding, any arrears of service charges or maintenance fee to be paid by the tenant, any eviction notice that has been served upon the tenant and any increase in rent that has been stipulated or otherwise notified to the tenant.

Before closing of the contract, the purchaser may, among other things, require the seller to warrant that all rents collected would be transferred to the purchaser, no new tenancy would be entered into while the deal is being negotiated and that all the pending and incomplete maintenance and repair work will be duly completed by the seller before the contract is concluded.

In this jurisdiction, estoppel certificates are not required as a precondition to conclude the contract of sale.

23 Leases and real estate security instruments

Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

In the UAE, a mortgage is the customary way of creating a security interest over real property.

According to Law No. 14 of 2008 Concerning Mortgages in the Emirate of Dubai, a tenant may mortgage his or her interest in respect of a long-term lease for a term between 10 and 99 years. The lease may only be mortgaged to a bank, company or financial institution that is licensed by the UAE Central Bank.

Hence, a mortgage over real property ranks highest in priority as a security instrument. Tenants are not required to give subordination and non-disturbance agreements to the lenders.

24 Delivery of security deposits

What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

It is customary for tenancy contracts and leases to provide for a refundable security deposit to be paid by the tenant or lessee at the commencement of the contract. In Dubai, Law No. 26 of 2007 regulating relationships between landlords and tenants recognises that a security deposit can be collected by the landlord as mutually agreed between the parties to the contract. Letters of credit are not prevalent in this jurisdiction and generally security deposits are paid by cheques.

Local laws of each emirate generally provide for periodic rent reviews.

For instance, in Dubai, Decree No. 43 of 2013 was passed to regulate rent increases in both residential and commercial leases in Dubai. The RERA issues the rental index or a rent cap decree or regulation periodically, setting forth the maximum permitted increase in rents or rent cap for properties in different areas for a particular time period. As per the Dubai Laws, for tenancy contract renewal purposes, the landlord and the tenant may review the rent value and if no agreement is reached and the necessity for extension of tenancy period is proved, then the Judicial Committee for the Settlement of Rental Disputes shall decide extension of tenancy period and determine rent value according to similar properties in the same area.

25 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain a zoning report or legal opinion regarding legal use and occupancy?

The land departments of different emirates maintain the property register wherein real estate rights are recorded. However, this register is not open to the public and cannot be accessed without the owner's consent or without a power of attorney by the owner. Generally, only interested parties, judicial authorities, experts appointed by judicial authorities and other competent authorities can inspect the property register.

Before entering into real estate transactions, getting a thorough legal due diligence done by lawyers has now become a customary practice in order to ensure good and unencumbered title to the property being purchased. Generally, the seller provides documentation to prove his or her authority to sell the property and details of any mortgages or encumbrances underlying the property. The documents reviewed by lawyers for the legal due diligence checks typically include zoning and land use reports, plot affection plan, plot and building site plans, etc.

All real estate rights are recorded in the relevant property register maintained by the land department of the respective emirate. Priority is determined based on the date of registration in the register. The same principle applies for registered mortgages as well.

26 Structural and environmental reviews

Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

Provisions governing the environment are found in the federal and local laws in the UAE. Emirates have their own environment departments, which look after zoning and compliance with environmental regulations.

For instance, all developments in Dubai are required to be approved by the DLD and the Environment Department of the Dubai Municipality.

Further, developers must identify areas of environmental importance or sensitivity and which of their activities may cause harm. They must also undertake an environmental impact assessment for their project.

In this jurisdiction, environmental insurance is not commonly taken out.

27 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

A lease is usually reviewed by lawyers or legal consultants in the UAE.

Depending on which party is being represented, we review the lease agreement and advise on the term of the lease, the governing law and jurisdiction chosen, the title of the lessor to the premises being subject to the lease, proper execution of the agreement, details of the property being leased, rights of assignment, warranties and representations of either parties, indemnity provisions and the risk exposure of the party being represented.

Property management agreements are also reviewed by lawyers and typically lenders would require any payables under the property management agreement to be subordinate to the mortgage loan agreement.

28 Other agreements

What other agreements does a lawyer customarily review?

Based on the client's instructions, lawyers in this jurisdiction would customarily review all documents relating to real estate, including sale and purchase agreements, title deeds, brokerage agreements, real estate management agreements, reservation contracts, jointly owned property documents, disclosure statements and also financing agreements.

29 Closing preparations

How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

Before the closing of an acquisition, leasing or financing, it is important to make sure that all the required documentation is in place. Typically, the closing of a transaction could take any time between four to six weeks. However, in the case of a cross-border transaction, the time taken could increase and would vary from case to case to ensure due execution of the documents. Generally, the funding for a transaction is simultaneous with the closing of the transaction.

The lenders' requirements in order to grant loan or funds vary depending upon the value of the property and the nature of the

transaction. However, lenders specify what they would require for the funding to be in place well in advance before closing the deal.

30 Closing formalities

Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

The parties do not need to be physically present for the closing of the transfer. The agreements can be executed by giving a duly executed and notarised power of attorney to a lawyer or representative. The transaction is usually concluded at the registration department of the respective land department or at the office of a registration trustee.

31 Contract breach

What are the remedies for breach of a contract to sell or finance real estate?

Generally the contract of sale contains the provisions for breach of contract by either party. Typically, the remedy for breach of contractual terms is by way of damages and interest awarded by the court of appropriate jurisdiction. Specific enforcement is not customary and is rarely prayed for. Instead, parties may try to settle and negotiate out of court before the judgment, wherein payment schedules may be restructured and the seller may continue to deliver the property to the investor.

32 Breach of lease terms

What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply?

The contract of tenancy or lease generally stipulates that on breach of any of the provisions contained in the lease, the other party will be entitled to serve a notice upon the defaulting party and then terminate the lease and re-enter the leased premises. In the event that the breach is not remedied, the landlord or tenant may initiate legal proceedings in the appropriate forum for determination of the dispute and to recover damages, costs and interest.

Financing

33 Secured lending

Discuss the types of real estate security instruments available to lenders in your jurisdiction.

Registered mortgages over real property are the best type of security interest that can be obtained in relation to real estate in this jurisdiction. Although a federal subject under the UAE Constitution, different emirates have enacted their own laws governing real estate and the registration of security interests in real property.

The UAE Civil Code requires that in order to be able to mortgage real property, the mortgagor must own the property and be capable of disposing it.

In the emirate of Dubai, notwithstanding the provisions of the UAE Civil Code, the Dubai Mortgage Law No. 14 of 2008 specifically permits mortgages over a lease with a term of 10 to 99 years and also a mortgage over an off-plan property.

Mortgage over real property in the UAE creates a charge on the property in favour of the lender, but does not 'convey' the property to the lender.

34 Leasehold financing

Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

Financing of leases, for both commercial and residential property is commonplace in the UAE. Generally, lending institutions have similar financing structures for land ownership transactions as well as for leases, with differences mainly in relation to the documentation involved.

In the UAE, there is no fixed minimum term as such for a lease being financed. Various financing options are available even to lessees of a short-term lease, depending on the type, term and purpose of the lease. However, it is unlikely that financing for a lease with a term of less than 12 months could be obtained since it might not be commercially viable for the lending institutions.

35 Form of security

What is the method of creating and perfecting a security interest in real estate?

The UAE Civil Code states that a mortgage over real property must be registered in order to be valid. It must be over property that actually exists at the time of the mortgage and must be granted against an ascertained debt.

A mortgage is typically recorded in the land register maintained by the relevant land department in the emirate where the property is located. Emirates maintain their own land register where a mortgage can be recorded, which gives lenders priority on the basis of the 'first to record' principle.

A mortgage over real property can only be registered in favour of banks and financial institutions licensed by the Central Bank of the UAE.

In Dubai, a mortgage is recorded using a standard form mortgage agreement prescribed by the DLD, which must be signed by the mortgagor and mortgagee. This agreement sets out the details of the property, the amount, details of the facility and the term of the mortgage. A real estate mortgage cannot be for an unspecified period and must end on a definite date. (See also questions 3 and 23.)

36 Valuation

Are third-party real estate appraisals required by lenders for their underwriting of loans? Must appraisers have specific qualifications?

Third-party real estate appraisals and valuation are commonplace in this jurisdiction and often required by lenders.

In the emirate of Dubai, the Real Estate Appraisal Centre (also known as Taqyeem) was established in 2009 as part of the DLD to regulate the real estate valuation profession and to licence valuation companies and register individual valuers.

Also, the Emirates Book Valuation Standards have been issued by Taqyeem, which lay down the standards for real estate valuation in Dubai and must be followed by all valuers.

Recently, in August 2015, Resolution No. 37 of 2015 on regulating the Profession of the Real Estate Appraisers was passed. This resolution aims to restrict the profession to qualified real estate appraisers who are listed in the RERA database. The resolution stipulates that only Emiratis or UAE nationals are permitted to become real estate appraisers, and they must have the necessary qualifications and training specified in the resolution. The appraiser must also have a minimum of two years' work experience or must have completed the training as specified in the resolution.

37 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

In this jurisdiction, the lender should be a bank, company or financial institution that is duly licensed and registered with the UAE Central Bank to provide finance for property in the UAE. Hence, third parties, that is foreign banks or financial institutions that are not so licensed and registered, wishing to take a mortgage over property in Dubai will need to make arrangements with a local bank to act as a security agent.

Update and trends

The draft law on protection of property investors (also known as the Real Estate Investor Protection (REIP) law) in the emirate of Dubai has been circulated for public consultation. The REIP law attempts to introduce several disclosure requirements that the developer must follow before it can announce a new project, and further holds the developer responsible for any disclosures made. This law, when it comes into effect, will allow for an increased level of due diligence on the part of the investors before making an investment decision and is a welcome development.

Also, the doubling of the registration fee on real estate transactions by the DLD and the UAE Central Bank's cap on mortgages have been a significant deterrent to property flipping and speculation.

Further, with the long-awaited Commercial Companies Law coming into effect early in 2015, there is added reassurance in the effectiveness of the legal framework existing in the region, and this would be further strengthened by the coming into force of the draft REIP law, which would serve as a step towards enhancing transparency and accountability in the system.

38 Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

The interest rates for loans in the UAE are generally based on the recommendations of the UAE Central Bank or the EIBOR as declared by the Central Bank.

39 Loan default and enforcement

How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

The recourse that may be taken against a debtor in default in the UAE varies from emirate to emirate.

In the UAE, there are no statutory rights of enforcement or foreclosure remedies available under the law, and therefore any enforcement must be routed through the courts.

For instance, in Dubai, the mortgage law sets out the procedure for the enforcement of mortgages in the event of a default. Any clause in the agreement entitling the lender to ownership of the property on the occurrence of a default is void, and the lenders must petition the execution court to dispose of the property. The mortgagor is served a 30-day notice via the notary public after which the lender can proceed to file for execution if the debtor continues to default on payment. Once the execution court renders its debt judgment, the property is attached and sold via public auction through the DLD. This sale via public auction can be postponed by a 60-day period on the application by the debtor to the execution court.

40 Loan deficiency claims

Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

In principle, lenders are entitled to recover any deficiency between the outstanding loan amount and the amount recovered in foreclosure from the borrower or guarantor in the emirate of Dubai. However, the express wordings of the loan documentation also have to be taken into account and it needs to be ascertained whether the loan transaction stipulates 'non-recourse' to the borrower or not. There is no specific limitation period for lenders seeking a deficiency judgment in the UAE. However, the presumption would be 15 years as it is for contract enforcement.

41 Protection of collateral

What actions can a lender take to protect its collateral until it has possession of the property?

When a property has been mortgaged in the UAE, the debtor retains possession of the land and the mortgagee receives the proprietary rights pursuant to the written mortgage deed. A mortgagee in the UAE cannot exercise self-help rights and hence cannot become a mortgagee in possession. However, in certain cases the lender can apply for precautionary attachment of the property. In such a case, the lender has to provide an indemnity for the property being attached and will be liable to the extent of the indemnity in the event of a loss.

42 Recourse

May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

Typically, recourse in security documents is limited to the collateral. During the bankruptcy or insolvency filing, duly registered collateral will have priority over other unsecured creditors. Personal recourse to shareholders is possible during a bankruptcy or insolvency proceeding if there is evidence as to financial management and breach of trust has been established.

43 Cash management and reserves

Is it typical to require a cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

Not relevant in this jurisdiction.

44 Credit enhancements

What other types of credit enhancements are common? What about forms of guarantee?

Various forms of guarantees are given as additional security in this jurisdiction, such as payment guarantee and performance guarantee.

A lender seeking to enforce a guarantee first needs to notify the primary obligor of his or her default by serving a legal notice. A lender can then file either for attachment first and later commence substantive legal proceedings or commence legal proceedings immediately.

On execution, the guarantor's assets will be liquidated and any funds realised from such liquidation of assets will be paid to the lender to the extent of the liability under the guarantee. The surplus, if any, would revert back to the guarantor.

45 Loan covenants

What covenants are commonly required by the lender in loan documents?

Commonly used covenants in loan documents may include undertakings by the borrower such as: to supply financial information to the lender such as audited and management accounts; that the borrower will not take any action to affect the ranking of the facility; an undertaking by the borrower to maintain and keep the property in good repair and keep it insured; and restrictions on carrying out fundamental alterations to the property, etc.

For a freehold property, the contractual obligations are solely between the holder of the freehold title and the financing institution. However, for leasehold property, it will be incumbent for financial institutions to review lease agreements and ascertain the rights of the lessee to use the lease property as security. Further, financial

institutions will have to ascertain if any specific consent is required from the lessor. In addition, financial institutions will need to look into the eventualities of a dispute between the lessor and the lessee and would therefore require further security documents in the form of guarantees and undertakings.

46 Financial covenants

What are typical financial covenants required by lenders?

The financial covenants required by lenders would depend on the type of loan chosen and would differ from case to case. However, the Mortgage Regulations issued by the Central Bank of the UAE in 2013 have defined the eligibility of various borrowers based on loan-to-value ratios as laid down by the regulations.

Further, the regulations state that the maximum term of a mortgage is 25 years. The regulations require lenders and financers to put in place proper processes and procedures to ensure that accurate information is collected regarding a borrower's income in order to determine a borrower's ability to repay the loan.

Loan providers are required to develop standard debt burden ratio calculation templates for this purpose. In addition, the maximum financing amount allowed for UAE nationals is set at eight times their annual income and at seven times for non-UAE nationals.

47 Secured moveable (personal) property

What are the requirements for creation and perfection of a security interest in moveable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

The UAE Civil Code provides for a pledge to be created over a moveable asset by delivery of the asset from the pledgor to the pledgee. In the case of such a possessory pledge, the debt must be ascertained; the pledged asset must be in existence and be capable of delivery and being sold by public auction.

A pledge is perfected on the date that the borrower transfers possession to the lender or its agent and the parties execute a pledge agreement. This document must have an Arabic translation, and it is essential to have the document executed in front of a notary public and get the document notarised.

The registration requirements for pledges on moveable assets in free zones are different from those in the rest of the UAE.

Besides the above form of possessory pledge over moveables, a debtor in the UAE is entitled to create a mortgage over its business premises, in favour of banks and financial institutions licensed and governed by the Central Bank of the UAE. The commercial mortgage enables the creation of security over the business as a going concern encompassing all tangible and intangible assets of the company but excluding real estate.

Such a mortgage needs to be effected through a written and duly executed mortgage deed, notarised and registered in the Commercial Register maintained by the relevant department of each emirate. The mortgage entry in the Commercial Register shall be valid for a period of five years. Mortgage over a commercial business entitles the mortgagor to possession of the assets.

Other common forms of security include personal and corporate guarantees, assignment of receivables and pledge over shares or accounts.

48 Single purpose entity (SPE)

Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

Not relevant in this jurisdiction.

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General

1 Legal system

How would you explain your jurisdiction's legal system to an investor?

Each state within the US other than Louisiana (which employs a civil law system) follows the common law tradition, which means there are codified laws that are interpreted by courts following precedent from prior court cases. There are three levels of laws in the US: federal, state and local. Laws evolve through both legislative action and judicial interpretation.

US courts will also rule in equity, which includes taking into account a party's conduct. If a party has acted with 'unclean hands', courts will consider that party's conduct when ruling.

Most states in the US allow a party to obtain an injunction, including a temporary restraining order, preliminary injunction or permanent injunction, depending on the applicable facts and circumstances and provided the party meets the relevant legal standards for obtaining the injunction, including that it has been damaged and that monetary relief will be insufficient compensation or protection.

When enforcing a contract, courts generally rely on the content of the contract without reference to parol evidence, unless the parties' intent in the written instrument is unclear. Rules of parol evidence vary from state to state.

While courts generally enforce both written and oral contracts (although the latter is more complex and requires the parties to meet more rigorous evidentiary requirements), contracts for an interest in real estate, including a contract of sale, a mortgage (or other similar security instrument, as described below) or an easement, are required to be in writing under the Statute of Frauds in each state.

2 Land records

Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

Each state in the US has a recording system, and there is a recorder's office in each county (or town) within a state. The recorder's office records ownership interests in real estate and other interests such as leasehold and security interests. Parties who have an interest in real estate routinely record their interests to put others on constructive notice of their interest and, if they are lenders and have a security interest in the real estate, to assure their priority interest as a lienholder. The general (though not universal) rule is that whoever records his or her interest first has a higher priority, but often subject to his or her lack of receipt of prior notice and delivery of value. Recordation is not a legal requirement for enforceability, as between the parties to the instrument, but it is routinely recommended by attorneys and undertaken by interest holders. In some instances, failure to record will cause the party's interest to be subordinate or subject to the interest of a subsequent purchaser for value without notice of the prior grant or a prior recording.

The Torrens system of property registration, which at one time existed in several states, is rarely used where it still exists. In jurisdictions where it still exists, it is voluntary and functions side by side with the recording system. But if land ownership is registered in the Torrens system, security instruments and all other instruments must be registered there as well, as recording such subsequent instruments outside of the Torrens system would be ineffective.

3 Registration and recording

What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

Each state imposes its own requirements for the recordation of documents. In order to be submitted and accepted for recordation, most documents need to be acknowledged in statutory form before a notary or similar official. Additionally, states have varying requirements for document size, width of margins, required recording legends and information, original or certified signatures and/or evidence of due authorisation and execution. Also, the recorder's office generally requires payment of certain recording fees and taxes that vary depending on the city, county and state of recordation.

4 Foreign owners and tenants

What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

Foreign persons must comply with federal reporting requirements in connection with certain purchase and investment transactions. In addition, though rarely brought to bear, foreign owners and investors must be cognisant of the powers of the Committee on Foreign Investment in the United States (CFIUS). Foreign purchasers are expected to notify CFIUS in advance of closing and CFIUS has the power to review any such pending transaction as well as other transactions of which it becomes aware, even if notice was not given. CFIUS may undertake review and, if it determines a national security interest is at stake, may disallow or rescind a transaction involving the acquisition of real estate in the US.

5 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

There are no material controls prohibiting a foreigner from owning real estate in the US, other than limitations existing in certain states pertaining to ownership of agricultural land and natural resources. Federal and state governments may withhold taxes from non-residents under the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) and similar laws. In addition, foreign investors are typically taxed on their US real estate investments in the same manner as US investors and have to file US federal and potentially state tax returns, unless certain structuring techniques are employed.

6 Legal liability

What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

Owners, tenants, operators, lenders and sellers face several types of liability, some of which are the result of statutes passed by the local, state or federal government, including environmental laws, which require an owner not to permit hazardous substances on the subject property and to clean it up if it becomes contaminated. Other liabilities can be created by contracts between the owner and other parties. The federal government has enacted legislation to ensure contamination is remediated from the property, including making a purchaser of contaminated property liable for remediation even if the purchaser did not know (but should have known) about the contamination. Most states have environmental laws as well. A purchaser is expected to perform environmental due diligence and, if deemed necessary, appropriate testing before purchasing any property.

An owner or operator (including a tenant) of real estate can be held liable to guests, invitees and third parties if they are injured while on the property. Landlords and other property owners can be held liable for failing to properly maintain their property or to correct legal violations, failing to disclose dangerous conditions, defects in new construction, failing to repair and maintain the premises, and failing to provide essential services. In some jurisdictions, an owner is required to provide additional disclosures about the condition of the property. Owners and landlords should be careful and seek legal advice because state laws continue to expand on the disclosures owners and landlords are required to make.

7 Protection against liability

How can owners protect themselves from liability and what types of insurance can they obtain?

Owners often take title to real estate in a separate entity, such as a limited liability company or corporation, which provides some protection from liability. Owners also typically obtain liability insurance (to insure against third-party claims for injury), title insurance (to insure against title defects), casualty insurance (to insure against property or physical damage), construction, business and rental interruption insurance, among other coverages.

Given the expense involved in remediating environmental matters, purchasers should consult a qualified environmental consultant and counsel to inspect the property before purchase. Environmental insurance can be obtained, but it can be expensive, may contain limits that do not cover all remediation costs and may have exclusions.

8 Choice of law

How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

Choice of law requirements can vary from state to state in the US. In a purchase and sale transaction, the contract of sale is typically governed by the law of a jurisdiction bearing a reasonable relationship to the transaction, as determined under relevant state law, often the jurisdiction with the strongest relationship to the transaction. Depending on the state involved, this could be the law of the state where one or more of the properties subject to the contract is located, a state where the purchaser or seller is organised or resident, or the state in which the transaction was negotiated or signed, or where material steps toward finalising the contract occurred. The parties must refer to the specific choice of law requirements of the various states related to the transaction in order to determine which choice of law criteria must be met. The contract of sale may also specify the venue where a case is to be brought. The court chosen for venue may be in the state whose law governs the agreement, or may be another location that may or may not have a relationship to the subject transaction. It should be noted that a court may refuse to hear a case even if it is the court designated as the proper venue under the agreement if certain minimum criteria are not met, such as amount-in-controversy thresholds or applicability of that state's laws. Additionally, after a case is brought a defendant may attempt to change (and may succeed in changing) the venue based on an inconvenient forum or other venue-related argument.

With respect to security instruments, the governing law for purposes of creation, attachment, perfection and enforcement of such security interests is typically the law of the jurisdiction in which the subject real estate is located. The governing law for other purposes (ie, the debt and general contractual purposes) may be the same or the law of another jurisdiction that is generally applicable to the larger transaction. With respect to other conveyancing instruments, such as deeds, ground leases or space leases, the governing law is typically the law of the jurisdiction in which the subject real estate is located.

9 Jurisdiction

Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

Subject-matter jurisdiction is the authority of a court to hear and decide the issues in dispute in a particular case. Generally, if a real estate dispute arises between citizens of the same state, that state's court will have jurisdiction. Federal courts are courts of limited jurisdiction; that is, the courts may only exercise jurisdiction over those matters to which Congress has granted them jurisdiction or where there is a diversity of citizenship between the parties and the matter has been commenced in the plaintiff's home state.

If the dispute is based on an alleged breach of contract, necessary parties include the parties to the contract. In real estate, necessary parties typically include anyone who has an interest in the property and the outcome, including the owner and possibly others.

In addition to jurisdiction over the subject matter of the dispute, the court must also have personal jurisdiction; that is, jurisdiction over the party involved. This requires first that the defendant have sufficient minimum contacts with the jurisdiction to satisfy relevant constitutional requirements of due process. Second, the party must be properly served with the pleadings. Federal courts and each state have their own rules and procedures governing service of both in-state and out-of-state parties.

Many states have rules requiring that an out-of-state entity be qualified or licensed to do business in its state. The failure to qualify to do business or obtain a licence within the state does not necessarily bar an entity from pursuing its remedies if the court otherwise possesses jurisdiction over the subject matter and the defendants.

10 Commercial versus residential property

How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

Residential real estate transactions (typically defined in a state as either single family homes, condominium units, cooperative apartments or multi-unit rental buildings containing a small number of units) are generally more regulated than transactions involving commercial properties, whether involving sales, financings or leases. There are more disclosure requirements to be met by the parties involved (lenders, sellers, brokers and landlords).

11 Planning and land use

How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

There is extensive federal, state, county and municipal legislation that regulates land use, development and construction on real estate. Each jurisdiction typically has its own regulatory scheme, which often includes zoning codes, preservation statutes (including landmark and historic district designations), building codes, incentive and

redevelopment programmes, subdivision requirements and environmental and natural resource protections.

12 Government appropriation of real estate

Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

There is a concept called 'eminent domain' in the US. It allows for the compulsory acquisition of private property. Property may be taken by the government or a third party with government approval for a public purpose, civic use and, in some cases, economic development. This includes government buildings, highways, railways, public utilities and public safety. Except in certain limited instances involving property impeding federally regulated navigable waterways, when property is taken, the owner of the property is entitled to 'just compensation,' which is the property's fair market value and what a willing purchaser might pay for it. States vary on how they determine fair market value.

13 Forfeiture

Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

Real estate can be forfeited or seized by the government if it has been abandoned or if the government determines illegal activities have taken place on the property or such property was acquired with proceeds of such illegal activity. Each state, as well as the federal government, has its own forfeiture rules.

14 Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency system in your jurisdiction.

Under federal law, a lender holding a recorded real estate security instrument is a secured creditor with all the applicable protections. Once a bankruptcy case is filed, an automatic stay goes into effect, which stops creditors from taking most actions against property of the debtor. The stay lasts until a bankruptcy court order lifting the stay has been entered or the stay has expired. The federal Bankruptcy Code recognises the concept of involuntary bankruptcy, which generally permits creditors holding the required amount and type of unsecured claims to force the debtor into bankruptcy by filing a petition for an order for relief. A trustee appointed by the court for a debtor or a debtor-in-possession may, subject to court approval, assume or reject the debtor's executory contracts and unexpired leases within the statutory time period unless extended by court order. The automatic stay prevents a creditor from terminating a lease prior to the trustee's decision to assume or reject it, even if the debtor is in default on post-petition obligations (however, such a creditor may be entitled to adequate protection).

A business may reorganise under Chapter 11 of the Bankruptcy Code, and a debtor-in-possession has all the rights and powers, and must perform all the functions and duties of, a trustee serving in a case.

Investment vehicles

15 Investment entities

What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

A variety of different legal entities can be used depending on the jurisdiction, including limited liability companies, corporations, general partnerships, limited partnerships and trusts. Limited liability companies, general partnerships, limited partnerships, tax-option (S) corporations and trusts not taxed at the entity level are all pass-through entities. Investors often use one or a combination of the above to shield themselves from personal liability or for tax purposes or sponsor's estate-planning purposes.

16 Foreign investors

What forms of entity do foreign investors customarily use in your jurisdiction?

Similar to domestic investors, foreign investors often use a limited liability company to invest in real estate. However, the choice of entity will be influenced, in part, by the long-term plan of the foreign investor (that is, does the investor intend to flip the property or buy and hold the property, will the property be for the investor's own use or leased out to tenants, etc), as well as the residence of the investor or entity, as tax agreements and treaties vary from country to country.

17 Organisational formalities

What are the organisational formalities for creating the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

Depending on the type of entity being formed (for example, limited liability company, corporation or general or limited partnership), counsel will frequently prepare the initial governing documents (articles of incorporation, certificate of formation, operating agreements, shareholder agreements, general and limited partnership agreements, etc) and filings required with the appropriate state official or agency to establish the entity; however, ongoing legal formalities must be followed and periodic taxes paid to ensure that corporate existence and legal protections are preserved, and counsel can guide the investor in these matters. Each state where a property is owned or taken as security for a mortgage loan by an entity formed in a different state may require the separate qualification and possible licensing of such entity, which may be liable for reporting and taxes in that state. Failure to do so may result in the entity's inability to use the courts in that state as well as subjecting the entity and, in some cases its directors, officers or agents, to monetary fines.

Foreign entities will be subject to FIRPTA and possibly state-implemented tax regimes with respect to taxes and potential withholdings of sales proceeds and the International Investment and Trade in Services Survey Act with respect to certain reporting requirements. Failure to comply with FIRPTA reporting and withholding requirements may result in the imposition of the property seller's tax liability that was not withheld onto the purchaser personally as a penalty.

Acquisitions and leases

18 Ownership and occupancy

Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

Ownership of real estate typically refers to having a fee simple interest in the property (ie, an estate that continues forever and includes all fixtures, minerals and appurtenances). Lesser estates include ground leases (the right to use and possess the property or portion thereof demised pursuant to the ground lease for an extended term, frequently the right to build and own the buildings on the land during the term of the lease and the obligation to pay all costs associated with the land during the term, such as taxes and insurance, such that the fee owner has no financial obligations during the lease term) and leases (the right to use and possess the property or portion thereof demised pursuant to the lease for a finite period of time, with more restrictions imposed by the owner during the term regarding the use and development of the property). Fee simple interests can be owned 100 per cent by one party (individually or in an entity) or by multiple parties (for example, as joint tenants, tenants in common, tenancy by the entirety or community property (married individuals with a right of survivorship) or as the owner of a condominium with a shared right to common areas within the development). Ownership is typically transferred by the use of a deed. The form of deed used to effect a property transfer varies from state to state, and in many states varying types of deeds are available, depending upon whether the sale is intended to be with or without any representation, warranty or covenant by the seller. Some common deed

forms are quitclaim deeds, bargain and sale deeds, warranty deeds and special warranty deeds.

Leases are customarily created through lease agreements, but unlike deeds, are not typically recorded, although in some instances a memorandum of lease may be recorded depending on the transaction but especially in the case of a ground lease. Other encumbrances such as covenants, conditions and restrictions, easements, reservations of rights and the like are typically recorded in order to provide record notice of such rights and restrictions and to bind subsequent owners of the property and lenders.

19 Pre-contract

Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

It is not uncommon for parties to agree on a non-binding letter of intent or term sheet before executing a binding contract of sale. This document generally outlines key business terms to be incorporated in the binding contract. If the document is identified as a letter of intent or term sheet and states that it is non-binding, courts generally will not enforce it. Courts understand that the purpose of the letter of intent or term sheet is to bring the parties closer to completing a transaction, but by making it non-binding the parties have retained their right to not consummate the deal. Sometimes non-binding letters of intent or term sheets include certain provisions that the parties expressly agree will be binding, such as the payment of certain fees or costs, or agreement to an exclusivity period during which the property will be taken off the market, allowing the parties time to negotiate a binding contract of sale.

20 Contract of sale

What are typical provisions in a contract of sale?

Sale contracts typically include a description of the property (the land, improvements, any personal property, leases, service contracts, entitlements and other intangible property), the business terms (purchase price and deposits, which vary depending on the deal size and bargaining power), the due diligence, inspection and escrow periods, the conditions to closing, the documents to be delivered at closing, the risk of loss, representations and warranties, restrictions on the seller until closing and the parties' respective remedies upon default, including any limitations on such remedies. Because the seller does not want the purchaser to terminate the contract in the event of a casualty, many contracts provide that the purchaser may terminate the agreement only if there is a material casualty (ie, a casualty that requires substantial sums to repair or that allows a tenant to terminate its lease).

In most transactions, in order for the purchaser to get comfortable with the state of title to the property, the seller provides the purchaser with a title report in advance of closing, prepared by a title insurance company, and the purchaser obtains a title insurance policy from a title insurance company at closing. Often, the title insurance limits or eliminates the necessity for the seller to make any representations concerning its ownership of the property, though this is a negotiable point and in any event the seller is generally required to represent that it has not previously transferred or otherwise hypothecated any portion of the property or any interest therein, other than leases and encumbrances shown on the title report and accepted by the purchaser.

At closing, the utilities are generally read the day prior to closing, and the real estate taxes are typically prorated on an accrual basis, so each party pays the taxes allocable to its period of ownership. In most transactions, the title company providing the purchaser's title insurance policy (or another escrow company) handles the exchange of funds and documents.

21 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

Any party that owns or operates or occupies (or has previously owned, operated or occupied) contaminated property may be subject to environmental liability. As between a purchaser and seller, the parties can negotiate who is responsible for the remediation, but any allocation of risk between the parties will not insulate them from liability in a governmental action. However, purchasers are cautious to take on such liability due to the uncertainty of the costs and time frame to complete any remediation, and a purchaser's willingness to assume such liability frequently depends on the extent to which the purchase price is discounted and the availability of environmental insurance. If the purchaser relies upon the seller to complete any remediation post-closing, there may be a holdback of the sales proceeds or guarantees from third parties, to satisfy any default of any remediation obligation. Parties should consult counsel before agreeing to any release of liability or indemnification related to environmental matters.

22 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

Because the value of a property (other than owner-occupied property) is often tied to the tenancies and resulting rents, it is customary for the seller to make a representation regarding the rent roll, any notices it has received from tenants regarding any defaults and any outstanding leasing commissions or improvement allowances. Purchasers typically want the right to approve any new leases or amendments to, or termination of, existing leases until the closing occurs. Purchasers and their lenders typically require the right to review and approve estoppel certificates (the form of which may be dictated by the lease or by the purchaser's lender) from some or all of the tenants, depending on the size of the spaces being leased and the number of tenants.

23 Leases and real estate security instruments

Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

Except in extremely limited circumstances, lenders typically require that leases be subordinate to their security instruments, and the property owner will therefore generally endeavour to enter into leases that are expressly subject and subordinate to any present or future security instrument without the need for any further documentation. However, even with such a provision, lenders will typically require tenants leasing significant space at the property to execute and deliver a subordination and attornment agreement, making the lease subject and subordinate to the lender's security interest in the property. Moreover, certain tenants with greater bargaining leverage will make the subordination of their leases contingent upon their receipt of the lender's recognition of the lease and agreement not to disturb the tenancy in the event of a foreclosure (ie, non-disturbance).

24 Delivery of security deposits

What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

Tenant security deposits held by the seller are typically transferred to the purchaser at closing. The purchaser will not want any security deposits applied after the execution of the sale contract. The determination as to whether a security deposit is required in connection with a lease is a landlord's credit decision, and in some instances national tenants may not be required to post a security deposit while smaller tenants frequently must. If a letter of credit is posted in lieu of a security deposit, the purchaser will want a new letter of credit issued in its name as beneficiary in connection with the closing.

Rent resets in leases are not common, except in connection with fair market rent determinations in options to extend or ground leases.

25 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain a zoning report or legal opinion regarding legal use and occupancy?

During the contract period, the seller generally provides the purchaser with a title report prepared by a title insurance company, based upon its review of the public record and municipal searches. In the contract, the purchaser is typically given a specified period of time from receipt of the report within which to raise objections. The seller then has the obligation or option (depending on the terms of the contract of sale) to either adjourn the closing date and address the title objections, or terminate the contract and refund the purchaser's deposit. At closing, the purchaser typically obtains a title insurance policy from a title insurance company, insuring that the property is vested in the purchaser, subject to certain exceptions to coverage, for which endorsements may be available to obtain affirmative coverage with respect to such exceptions.

The methodology for determining the relative priority of encumbrances on title varies by state. Most states follow a 'first to record (without notice and for value)' system, such that interests in the property are given priority based upon when they were recorded, but priority can be reordered by contractual agreement between or among interest holders. In addition, in many jurisdictions, certain liens are granted 'super-priority,' such as tax liens and mechanics' or materialmen's liens. In most states, the title company insuring the owner or the lender will issue an endorsement to its title insurance policy insuring the use and occupancy of the property under the applicable zoning law. In those states where title companies cannot issue a zoning endorsement, parties will rely on a local government certificate authorising the use and occupancy under the zoning law or in some cases on the report of a recognised zoning due diligence company. But if neither is available or if the transaction is overly complicated or there is an existing non-conforming use, an opinion of qualified zoning counsel is obtained.

26 Structural and environmental reviews

Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

In commercial transactions, given the potential risks involved, many purchasers will engage third parties, including environmental consultants, engineers and counsel, to perform environmental, property condition and zoning reviews and provide reports with respect thereto, which are in addition to any representations, warranties and indemnities the purchaser may be able to negotiate from the seller in the sales contract. Environmental site assessments must be conducted in compliance with all appropriate inquiries under the Comprehensive Environmental Response, Compensation and Liability Act, which are generally met by following the standards of the American Society of Testing and Materials (ASTM) 1527-2005.

27 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

Legal counsel is routinely involved in reviewing leases and preparing abstracts for purchasers and lenders, noting such things as any required estoppel certificate or subordination, non-disturbance and attornment agreement forms, any restoration requirements, any termination rights for tenants, any rights of first refusal or offer, any options to purchase, any rights to sublet or assign, any outstanding leasing commissions or tenant allowances, ensuring there is subordination language, if representing a lender, and confirming the business terms set forth in any rent roll (rent, security deposits, rent abatement, terms of lease, etc).

Property management agreements may be reviewed by counsel for the purchaser and any lender and the lender will typically want any fees under the property management agreement to be subordinate to the lien and payment of the security instrument and for the property manager to consent to certain lender termination rights set forth in the loan documentation.

28 Other agreements

What other agreements does a lawyer customarily review?

In commercial transactions, counsel will typically review the title report or commitment, together with any documents disclosed by such report or commitment, including any easements, covenants, conditions and restrictions and liens of record. Counsel will also typically review any brokerage agreements (at the onset of a transaction), as well as zoning reports and any surveys of the property to confirm any encroachments, the location of any easements, any potential setback restrictions, access and compliance with parking requirements. Counsel may also review material service contracts, such as those having a large dollar amount or a non-cancellable, extended term. If the property is subject to a condominium regime, development plan or tax incentive plan, or other similar arrangement, counsel will review the related documentation to determine its impact on the property and whether there are any requirements to send notices or obtain consents.

29 Closing preparations

How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

The attorneys prepare the closing documents to be signed by the parties (including the deed, assignment of leases and service contracts, bill of sale and notices to tenants regarding the sale), coordinate with the escrow officer, purchaser, seller and any lender regarding the execution and delivery of all documents and funding, prepare closing instructions, assist with confirming any prorations and finalising the settlement statement and confirm the title insurance policy is acceptable and has the appropriate endorsements.

Lenders will require that all of the loan documents be duly executed and delivered, and often require a legal opinion from the purchaser's counsel, in addition to a separate lender's loan title insurance policy.

The escrow period varies by transaction, and, depending on the county where the property is located, recording of the deed or security instrument may or may not occur on the day of closing. Provided the deed or security instrument has been delivered to the title company for recording, the title insurance policy typically covers any time lag or 'gap' between the date of closing of the sale or financing and recordation of the deed or security instrument.

30 Closing formalities

Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

Most commercial real estate closings (or settlements) are handled through escrow, and the parties do not meet in person to sign and exchange documents. Although certain documents, such as the deed or a security instrument, must be acknowledged before a notary,

generally no governmental agents need be present at closing. Many states, counties and municipalities have transfer taxes or mortgage recording taxes that must be paid in connection with the related sale or financing.

31 Contract breach

What are the remedies for breach of a contract to sell or finance real estate?

If the seller defaults in its obligation to complete the sale of real estate that has been agreed upon in a binding contract, the purchaser often has the right to sue for 'specific performance' of the terms of the agreement. If the purchaser defaults in its obligation to complete the purchase of real estate that has been agreed upon in a binding contract, the seller typically has the right to terminate the contract and retain the deposit as liquidated damages, and may also have the right, in lieu of terminating and retaining the deposit, to sue for specific performance. Depending on the facts, a court should enforce a party's binding obligation to purchase or sell property. In addition, real estate contracts sometimes provide that the prevailing party in any legal proceeding may recover its attorneys' fees in such litigation.

With respect to financing, as a general matter, upon the other party's default neither a lender nor a borrower is typically entitled to sue for specific performance of a binding loan commitment, but is entitled to sue for damages.

32 Breach of lease terms

What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply?

It is common for a commercial lease agreement to set forth the parties' respective remedies upon a breach. If a tenant breaches such a lease (such as a failure to pay rent), the landlord in many states is required to give notice of the breach to the tenant. If the tenant still fails to cure its breach (by payment of rent or otherwise), the landlord may commence an eviction proceeding. In many states, eviction proceedings are given priority in the courts, and some states have special landlord-tenant courts. Note also that, in order to avoid eviction in a situation where a tenant believes it is not in default under its lease, the tenant may need to obtain an injunction prior to the expiration of the cure period under the lease pertaining to the alleged default giving rise to the landlord's right to evict. In many states, the tenant may defend the eviction by raising defences such as prior payment. If the court finds the tenant breached and should be evicted, the tenant is required to vacate the property. If the tenant fails to vacate, the sheriff will assist in removing the tenant. Unless the lease provides otherwise, a tenant can claim damages from a landlord. Depending on the terms of the lease, the prevailing party may recover attorneys' fees from the losing party.

Financing

33 Secured lending

Discuss the types of real estate security instruments available to lenders in your jurisdiction.

The most commonly used real estate security instruments are mortgages, in which the lender is granted a lien upon the landowner's property as security for the debt, and deeds of trust, in which the landowner places its property in trust with a trustee for the benefit of the lender as security for the debt. The law of the state in which the property is located typically determines which form is used, but in practice, the effect of the two instruments is virtually identical. When the borrower's obligation is fully paid and performed, the mortgage is released by the mortgagee, and the interest granted under the deed of trust is reconveyed by the trustee to the landowner.

34 Leasehold financing

Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

Financings of ground (or head) leasehold interests are common in the US, and leasehold mortgages and deeds of trust are typically used to secure such indebtedness. The leasehold mortgage or deed of trust will include provisions specific to the financing of a leasehold estate, including representations and covenants from the borrower or lessee regarding the ground lease. Additionally, the lender will require an estoppel statement from the ground lessor regarding the status of the ground lease, and a recognition agreement from the ground lessor granting the lender certain rights to preserve the leasehold estate, including notice and cure of defaults and the right to obtain a new lease directly from the ground lessor in the event the ground lease is terminated or rejected by the borrower or lessee in bankruptcy. While some regulated institutional investors have statutory or regulatory limitations and others are formed with, or have adopted, policy limitations, or there is unwritten customary market guidance observed among other investors, the only limitations on the minimum remaining term of the ground lease or the maximum shorter term for the financing in relation to the lease is self-imposed prudent underwriting of the investor or the limitations imposed by the equity investor's lender providing the financing for the ground lease.

35 Form of security

What is the method of creating and perfecting a security interest in real estate?

While real estate security interests are created by execution and delivery of the security instrument between the parties, the security instrument must be recorded in local public real estate records to perfect a valid security interest in the property. A security interest in fixtures may be perfected in many states by including specific 'fixture filing' language in the recorded security instrument or by filing a separate Uniform Commercial Code financing statement on the fixtures in the county where the real estate is located.

36 Valuation

Are third-party real estate appraisals required by lenders for their underwriting of loans? Must appraisers have specific qualifications?

Institutional lenders typically require a formal appraisal performed by a licensed appraiser from an approved list; banks and other financial institutions are usually mandated under the Federal Financial Institutions Reform, Recovery and Enforcement Act of 1989 and applicable state law to obtain independent appraisals by qualified appraisers for new and modified real estate loans. Private lenders (particularly when relying on the creditworthiness of the borrower and guarantors rather than the value of the property) may use a more informal valuation of the collateral, such as an estimate of value by a real estate broker.

37 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

In some states, mortgage lenders must be licensed or otherwise authorised or qualified to make and enforce mortgage loans in the state where the real estate is located, while other states have no such requirements. Additionally, several states which have such requirements will allow a lender to make one or a limited number of loans secured by real estate in the state without qualifying to do business, or obtaining a licence, in the state. Several states impose recording taxes, filing fees and other similar taxes and charges in connection with the recordation of mortgages. Failure to pay the requisite recording taxes and fees may, in some states, prevent the lender from accessing the courts of the state to enforce the mortgage, and may even render the mortgage unenforceable. Investors may usually purchase a loan originated

Update and trends

With the international regulatory limitations being imposed by international and US banking regulators regarding limitations on construction loans as high-volatility commercial real estate and risk retention in commercial-backed securities transactions, the focus on increased capital for an asset class deemed the cause of bank losses is having an impact on bank and thrift investment in commercial real estate loans, constraining liquidity available from the usual sources. This is leading to the concomitant growth of private equity funds and unregulated specialist lenders who are outside the purview and control of the regulators. As these 'shadow banks' replace traditional lenders that are withdrawing from the primary and secondary mortgage markets, how will the commercial real estate market as we know it, with its capital and liquidity requirements, change in reaction to the unregulated entrants?

by a licensed or qualified lender without qualifying in the state where the real estate is located; the interest in the underlying note should be transferred by endorsement or allonge, and the security instrument assigned to the new holder by a recorded assignment. The assignment would typically not incur new taxes but would be subject to any applicable recording fees.

38 Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

Interest rates on mortgage loans are commonly based on a designated prime or base rate or one of a variety of LIBOR-based rates, but rates are often also based on interbank rates and various terms of US Treasury bonds, with spreads over the base rate ranging from zero to several points. Usury laws, which limit the maximum rate of interest that may be charged (including certain fees) as well as exemptions, vary from state to state, and are often different for residential and consumer loans, on the one hand, and commercial loans, on the other hand. Moreover, in some states certain lenders, such as banks, other financial institutions, insurance companies and licensed lenders, are exempt from certain specified limitations on interest rates. Some states offer exemptions from usury limitations for certain types of loans or for commercial borrowers or certain types of borrowing entities. The penalties for usury also vary from state to state and may include both penal and civil penalties as well as possible voidance of the debt.

39 Loan default and enforcement

How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

The typical first step in exercising remedies is for the lender to send written notice to the borrower that the debt is being accelerated due to default. The remedy of judicial foreclosure is available in all states, and is the only method of foreclosure in several states. The time frame for completing a judicial foreclosure varies greatly by jurisdiction, and frequently takes a year or longer to conclude. Many states also permit non-judicial foreclosure under a power of sale following default, which can typically be completed in a shorter period of time than a judicial foreclosure. The specific remedies available and the procedure for enforcing them are governed by state law, and practice varies significantly from state to state. At the foreclosure sale (whether judicial or non-judicial foreclosure), the lender may `credit bid' the amount of the debt but other bidders must appear at the sale with cash or a cashier's cheque. Several states allow simultaneous realisation on varying items of collateral, while others require election of remedies or sequencing of remedies. Actions for a deficiency judgment are discussed separately below.

Typically, to limit liability and for other reasons, institutional lenders do not take the property in their own names, but instead form a subsidiary or affiliate to hold foreclosed property.

40 Loan deficiency claims

Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

In many states allowing non-judicial foreclosure, a lender that chooses to foreclose non-judicially, under the power of sale, cannot obtain a deficiency judgment against the borrower. In most states, in order to obtain a deficiency judgment, the lender must file an action for judicial foreclosure. Under that process, the court determines the 'fair value' of the property, and then enters a deficiency judgment for the difference between the lender's claim and the value of the property. The methodology for determining the amount of the deficiency is often dictated by statute and varies from state to state.

Some states have 'one action', 'security first', 'election of remedies' or 'anti-deficiency' rules that create special issues for lenders. For example, California and several other western states in the US have a 'one action' rule that allows a lender only one action against the collateral or the debt. Seeking to recover funds against the borrower, by set-off or other equitable remedies, or by judicial action, carries a sanction that may result in the complete loss of the security interest. Loans secured by real estate in several states, and loans guaranteed by persons who have primary liability under the note, such as general partners of a partnership borrower, can also create special issues for lenders under such rules. When a state permits a lender to pursue a loan deficiency claim against a borrower or a guarantor, the prosecution of that claim is usually strictly limited as to when and how the claim must be asserted or otherwise be barred and how and by whom the value of the property and the amount of the deficiency is calculated. Notwithstanding the location of the property, if a lender chooses the loan to be governed by a different state law, that state's deficiency limitation or anti-deficiency law may apply rather than the law of the state where the property is located.

41 Protection of collateral

What actions can a lender take to protect its collateral until it has possession of the property?

Most security instruments grant the lender the right to petition the court for the appointment of a receiver following an event of default, and a court-appointed receiver is typically used by lenders to collect rents, protect business assets and minimise loss and damage at the real estate until the lender can obtain possession after foreclosure or the sale of the property to a third party. A lender may also make monetary advances to protect the priority of its lien or the property, for example, real estate taxes and casualty insurance premiums. If a lender attempts to take possession of a mortgaged property or exercise dominion and control over the property to the exclusion of the borrower, it will be personally liable to the borrower for its actions and inaction during the period of its control, notwithstanding the prospective prior authorisation by the borrower for such possession and control in any loan document. To insulate itself from such liability, in most cases a lender will seek the appointment of a receiver to protect the property and collect the rents notwithstanding that there is an assignment of rents for the benefit of the lender.

42 Recourse

May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

Except where anti-deficiency laws apply, recourse is a negotiable term. In many commercial mortgage transactions, particularly in capital markets mortgages, the borrower has no personal liability for the loan other than for certain specified actions, omissions or events such as fraud, misappropriation of funds, transfer of the property in violation of the loan documents, bankruptcy filing, and other significant defaults. Additionally, commercial mortgage transactions often include non-recourse carve-out guarantees covering the losses incurred by the lender due to certain specified actions, omissions or events, but may also provide for full recourse to the guarantor for the amount of the debt in the event of a bankruptcy filing, transferring or further encumbering the property without the lender's consent and certain other specified events. Other loan guarantees may also cover full or partial payment of principal, interest and carrying costs of the property, and in construction lending, guarantors often deliver completion and cost overrun guarantees. Commercial mortgage loans with no recourse whatsoever to a borrower or a guarantor are rare. But there are still many small lenders such as community banks that continue to lend on a full recourse basis.

43 Cash management and reserves

Is it typical to require a cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

Depending on the condition of the property and the type of business conducted, lenders may require reserves to support the borrower's credit. Escrows or impounds for taxes and insurance are most common, as well as ground lease payments and condominium association payments, if applicable, and construction loans will usually also include reserves or holdbacks for payment of interest. In non-construction loans, interest reserves are less common but may be required for a part of the loan terms, particularly where cash flow has not yet been established. Lenders often require a short-term reserve, typically funded from the loan itself, for costs of repairs required immediately. For retail or office properties facing tenant turnover, many lenders will require a tenant improvements and leasing commissions reserve, usually funded from monthly deposits made by the borrower; these funds are typically not released until a new tenant has taken occupancy and accepted the space, as confirmed by an estoppel certificate. Depending on the age and condition of the property, a lender may also require a capital improvements reserve, to be disbursed for improvements or repairs approved by the lender. If an environmental condition exists at the property requiring remediation, the lender may require an environmental remediation reserve be established at closing, to be disbursed to pay the costs of remediation.

Whether the lender requires a cash management system and the nature of it depends on both the status of the property and the lender's intended transaction exit strategy. While many capital markets lenders require cash management, balance sheet lenders often do not. A cash management arrangement may take several different forms; it may be set up at closing, with all property revenues running through a 'waterfall' designed to make required reserve deposits, or it may only kick in upon the occurrence of an event of default or another trigger event, such as the failure of the property to meet a debt service coverage test or the termination or expiration of a material lease. Some cash management arrangements implemented at closing allow the borrower to control all cash (by daily sweeps into a borrower-controlled account) until an event of default or other trigger event occurs, at which point the lender assumes control of the cash. The lender in a loan transaction without a cash management system would be most likely to seek a receiver for the property if the loan goes into default, in order to gain control over the property revenues going forward.

44 Credit enhancements

What other types of credit enhancements are common? What about forms of guarantee?

Even where the value of the property and the cash flow generated are sufficient to support a loan, it is not uncommon for a form of credit enhancement to be required, most commonly in the form of a guarantee applicable to certain actions, omissions or events, as more particularly described above. Other forms, such as standby letters of credit or cash collateral, are less frequently used.

For construction loans, or loans secured by properties needing substantial and immediate renovation or repair, a holdback of funds sufficient to pay all costs of the work (up to the entire amount of the loan, after payment of interest and fees) is typical, with funds disbursed as work is completed. It is common for construction loans to have third-party payment and completion guarantees. Recourse guarantees for losses and the entire debt for 'bad boy' acts are standard in loan documents and are regularly enforced in state and federal courts. While the bad boys acts covered by the guarantees may differ from lender to lender, full recourse for the entire debt is usually sought for voluntary bankruptcy and acquiescence in an involuntary bankruptcy of the borrower or guarantor, for the breach of SPE covenants by the borrower or the guarantor, or the transfer or mortgaging of the property without the lender's consent.

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45 Loan covenants

What covenants are commonly required by the lender in loan documents?

Loan covenants vary depending on the type of property, but generally will include maintaining insurance coverage, paying insurance premiums and real estate taxes when due, maintaining the property in good order and repair, not transferring or further encumbering interests in the property or the borrower, and complying with applicable law, including disabled access requirements and environmental conditions. For retail, office and other leased projects, covenants often include complying with the landlord's obligations under leases, obtaining the lender's consent to new and modified leases and enforcing the tenant's obligations; where a property is operated under a franchise, such as certain restaurants or hotel properties, the covenants will include strict compliance with the franchisee's obligations. Construction loans will typically include covenants to complete the project lien-free, in accordance with plans and specifications and by an outside completion date. See question 34 for the specific additional covenants of borrower or ground lessees in leasehold financings.

46 Financial covenants

What are typical financial covenants required by lenders?

Most loans include financial reporting requirements, at least annually but more frequently quarterly, and an underwriting requirement for a maximum loan-to-value ratio. Lenders often have the right to require subsequent appraisals, at the borrower's expense, but typically enforce that right only if there is an event of default or the loan is materially modified or extended. Other typical financial covenants may include a minimum debt service coverage or debt yield requirement, a minimum cash-flow requirement, and minimum net worth and liquidity requirements for the guarantor.

47 Secured moveable (personal) property

What are the requirements for creation and perfection of a security interest in moveable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

Moveable property (or personal property) is subject to the Uniform Commercial Code, which has been adopted (with some variation) in all states. A security interest in most moveable (personal) property can be perfected by entering into a written security agreement (often combined with the mortgage or deed of trust where a loan is secured by both real and personal property) and filing of a form UCC-1 financing statement with the Secretary of State's office in the state in which an entity borrower is formed or in which an individual borrower resides, regardless of where the property is located. A control agreement is required for cash or financial assets unless those assets are actually in the possession of the secured party. Special rules apply to intangible property.

48 Single purpose entity (SPE)

Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

Lenders often require that the borrower be a newly created SPE, and specific representations and covenants regarding the borrower's single purpose status are included in the loan documents and usually also in the organisational documents of the borrower. The requirement for one or more independent directors or springing members (whose vote is required to declare bankruptcy) is also frequently imposed, especially in capital markets lending transactions. Lenders sometimes also allow use of 'recycled entities' (ie, pre-existing entities) as borrowers, as long as they own only the property then being mortgaged and otherwise meet the SPE criteria specified in the loan documents.

Getting the Deal Through

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