The 2011 guide to

Real estate

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The 2011 Guide to Real Estate

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Back on track

The real estate market has been quiet in the wake of the financial crisis. However last year things began to improve and the next 12 months look to build on that success.

Private equity funds are investing again, while in the US, real estate investment trusts have been successfully tapping into the initial public offering market.

This IFLR supplement aims to present all the relevant case law, legislation, regulation, rules and legal issues for companies involved with real estate around the world in one place.

Whether your deal is in the UK or Slovakia, this guide will keep you up to date via jurisdictional specific legal chapters.

We hope you find this guide to be a helpful resource and one that you will turn to often.

Lukas Becker
Editor

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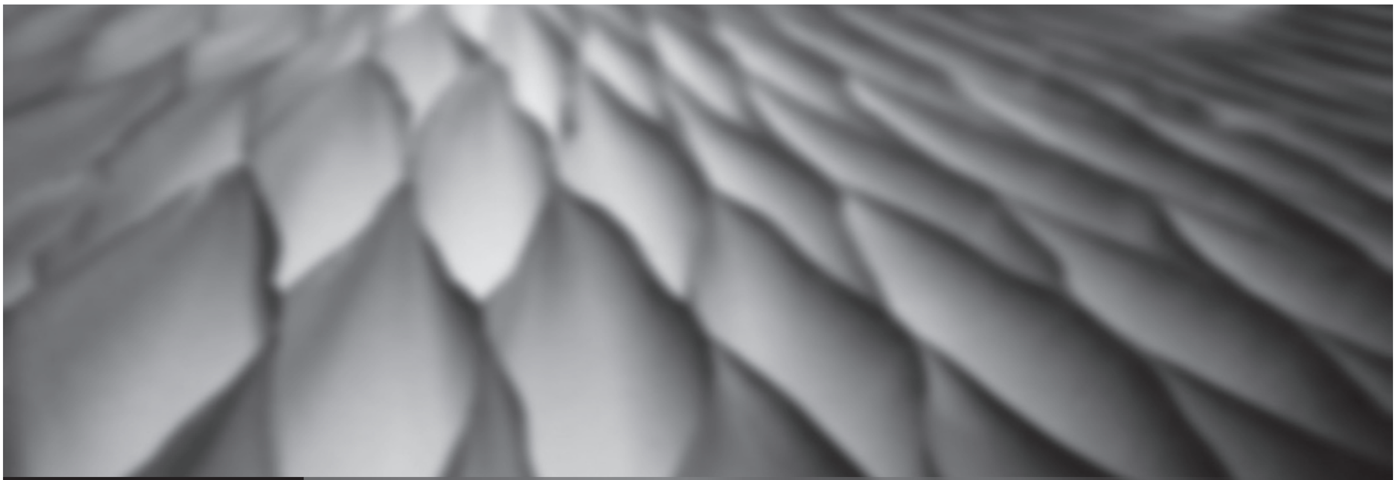

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Barger Prekop s.r.o. is a full-service law firm based in Bratislava, Slovakia. We assist domestic and international clients in complex legal issues and transactions. The founding partners, Mr. Adrian Barger and Mr. Roman Prekop, are respected legal practitioners on the Slovak and CEE markets. They each have over a decade of experience advising clients on a broad range of real estate, corporate, M&A, financing, regulatory and contentious matters.

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More stability, less growth

Adrian Barger and Soňa Princová of Barger Prekop summarise the conditions and outlook for the Slovak property market, which has emerged from the financial crisis with uncertain prospects

Following accession to the European Union, Slovakia enjoyed strong economic growth, with GDP rates consistently above 5% from 2004 through 2008. But the financial crisis hit Slovakia with full strength in 2009, decreasing its GDP by 4.7%. Thanks to revived economic growth and consumer spending in the primary export markets (Germany in particular), the Slovak economy has been recovering quickly, posting one of the highest growth rates among EU countries in the first quarter of 2011.

To a large extent, the situation on the real estate market has mirrored the economy as a whole. It appears that the Slovak real estate market has stabilised after several turbulent years of rapid growth followed by the shock of the crisis. The rapid decline in real estate prices seems to have stopped, or at least slowed down, and demand is picking up slightly, particularly in the area of residential property.

Significant regional disparities continue to characterise the property market in Slovakia, with most construction activity and demand concentrated in Bratislava. For example, as much as 73% of new apartments built in 2010 are located in the capital city, and average housing prices in the Bratislava region are almost twice as high as in other parts of the country.

Over the past two years, Slovak banks have adopted an increasingly conservative approach to property lending. Thus, along with increased portion of developers' equity contribution (usually in the range of 30–40%), banks often require higher pre-sales or pre-leases as a condition for financing. On the other hand, buyers are willing to commit only to projects that are already finished or well under construction. These factors place a great deal of pressure on developers and may drive the smaller players from the market.

The development of the Slovak real estate market in the near future will likely depend on the situation in the Eurozone. Unstable financial markets could cause both investors and buyers to hesitate, resulting in stagnation of the property market. Moreover, the expected growth of interest rates could dampen demand. Nevertheless, the fundamentals for a growing demand exist, as the market is fairly stabilised and prices relatively well set.

Residential property

Since late 2010, the supply of new residential projects has been growing moderately. However, experts do not expect a significant construction boom soon – at least not this year. Developers display some optimism regarding the market and demand for new apartments, but they remain very cautious and generally choose smaller projects. Given the weak purchasing power, there is also a lot of potential in the market for cheaper housing alternatives.

Construction of smaller apartments or reconstruction of existing working-class apartment houses may provide affordable accommodation for young families and lower-income people, but, unfortunately, these types of construction are unlikely to boost overall residential construction. In fact, data published by the Slovak Statistics Office reveal a decrease of 28.8% in permits issued for new construction in the first quarter of 2011 compared to the same time period in 2010, and the downward trend will probably continue for the remainder of 2011.

“Significant regional disparities continue to characterise the property market in Slovakia”

After the big drop in demand for residential property in 2009 and subsequent hesitation in 2010, statistics show a growing demand in late 2010 and early 2011, mostly thanks to favourable conditions on the mortgage loan market and the willingness of developers to make concessions. But only apartments or houses of good quality and in prime locations are attracting the interest of buyers. Property in less attractive projects, with bad layout or of low quality, is selling only if developers offer adequate incentives or price reductions. Therefore, despite the number of unsold apartments available on the market, finding a prime apartment in the second half of 2011 may be difficult, due to halted construction.

As mentioned above, the growth in demand is mostly attributable to the availability of mortgage loans. Interest rates for mortgages fell significantly in the second half of 2010, and this trend has continued in 2011, fuelled by fierce competition between banks (accompanied by rapid changes in their market shares). Analysts predict, however, that interest rates will increase toward the end of 2011, which may be accelerated by the debt crisis in the Eurozone and turmoil on the global financial markets.

An analysis by the National Bank of Slovakia for the first quarter of 2011 confirms the strong growth in mortgage loans. In May and June 2011, the number of mortgages granted reached a record high. Though this is largely attributable to refinancing of existing loans obtained under less favourable conditions, the number of new loans also increased. In addition, the analysis shows that new housing has become more affordable as the ratio between disposable income and housing prices increased. This could be another significant factor supporting growing demand for new housing.

Despite growing demand and low supply, it seems that new housing prices are stagnating after the years of rapid growth and the subsequent drop. According to statistical data published by the National Bank of Slovakia, which, together with the National Association of Real Estate Agencies, monitors prices, the average price per square metre of residential property was €1,264 ($1,810) in the first quarter of 2011, and €1,256 in the second quarter. The average price for apartments (€1,316/m^2) remains higher than for houses (€1,116/m^2).

These prices correspond to average prices in the third quarter of 2007, when Slovakia stood on the doorstep of its biggest real estate boom. However, a closer look at the data reveals that the price decrease mostly involves larger apartments and houses. On the other hand, prices for the most popular one- or two-bedroom apartments have remained stable or grown. Most experts expect neither a further drop nor a robust increase in prices. Nevertheless, price reduction seems to be necessary for developers trying to sell apartments in poorly designed projects or less attractive locations.

"Buyers are willing to commit only to projects that are already finished or well under construction"

Office space

The Slovak office space market is concentrated in Bratislava and dominated by a handful of powerful investors. This means that, if the demand for office space revives, the benefits will likely be reaped only by a few.

Construction of office space slowed or stopped after the crisis, limiting the supply of new space to projects which had begun before the crisis and which came on the market during the crisis or shortly afterwards. Speculative office property development is no longer present and the pre-lease market is almost non-existent. Only a few new projects are in the pipeline, mainly attributable to established players with enough cash, and who can take advantage of the extension requirements of their existing tenants. Consequently, in light of the low supply and despite the weak demand, firms looking for 5,000m2 or more of A-class space may find it very difficult to find suitable premises on the market.

The pressure on developers to reduce rents has eased

About the author

Adrian Barger is a founding partner of Barger Prekop. He is experienced in real estate, M&A, general corporate and commercial matters, EU law and competition, and banking and finance. He has been recognised as a noted practitioner in the fields of real estate, corporate law, and M&A in the Slovak Republic, and has also been listed as one of the Slovak Republic's leading individuals for corporate, commercial, and M&A matters.

With more than 10 years' experience advising reputable international and domestic clients, Barger is able to provide practical and in-depth advice on complex legal matters and transactions. He has led or assisted many acquisition transactions, including privatisations, joint ventures, and real property acquisitions, as well as related corporate and project finance deals.

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in 2011. While in 2010 developers were willing to offer considerable incentives in terms of fit-out contributions or rent-free periods, the situation changed this year, and not just for companies looking for several thousand square metres but also for companies needing only a couple of hundred. Landlords are slightly increasing headline rents and are less forthcoming in providing generous incentive packages to tenants.

Retail property and industrial parks

According to expert analyses, demand for prime retail space in the best locations remains stable in 2011. The expansion seen in the capital city over the past few years has been followed by an increasing number of retail projects of different types and sizes in various regions of Slovakia. In Bratislava, developers and investors are also seeking opportunities through new formats, such as the recent refurbishment and extension of several existing shopping centres and department stores.

In addition, investors plan to fill a long-time gap on the Slovak market – fashion outlets. Earlier this year, two competing developers announced projects to be located along the D1 highway near Bratislava. The first project is expected to launch in Autumn 2011, and the first phase of the second project is scheduled for completion in Spring 2012. The developers hope to attract not only Slovak shoppers but also customers from Austria, Hungary and the Czech Republic.

Overall market trends also affect the supply of modern warehouse and logistics space. Experts agree that construction has stopped due to more difficult financing terms and lower tenant interest. Developers are focusing on leasing existing space, and new developments are commenced only on a built-to-suit basis. There is almost no speculative construction. Rental prices remain stable (at between €3.00 and €4.50/m2) and vacancy rates are low. With improving road infrastructure, analysts await implementation of new projects in less-developed regions of Slovakia.

Asset management – commercial leases

Since the crisis cast its shadow over the Slovak real estate market, only a few acquisition or investment deals have been completed. Instead, work for property lawyers comes mostly from managing office, retail or industrial assets. There are various legal issues which are commonly encountered by local property managers and their legal counsel.

In Slovakia, entering into a lease relationship is often a two-step process. Before entering into the lease, parties commonly conclude a so-called future lease agreement, in which they agree on the conditions for entering into the lease. This concept is used particularly when the premises are still in the planning stage or under construction. The future lease agreement thus usually contains the duties of both parties during the permitting and construction process. Once the premises are completed and a valid occupancy permit is issued by the relevant building authority, the parties can sign the lease agreement. If the lease agreement is signed before the occupancy permit is obtained, by operation of Slovak law the lease could be deemed invalid. In addition, if the landlord allows the tenant to occupy the premises before obtaining the occupancy permit, the parties could face penalties for breach of construction regulations.

Another situation where future lease agreements apply is in the replacement of tenants. When parties negotiate a lease for premises which are still occupied by a previous tenant and they need to contractually bridge the period until the previous term expires or notice period elapses, they basically have two options. First, they can conclude a future lease agreement, in which the entry into a lease agreement is conditional on the valid termination of the previous lease.

Second, the parties can sign a new lease agreement which will become effective only when the previous lease has been validly terminated. However, according to older case law and some commentaries, such a new lease agreement could be invalid because the subject of the lease is not legally vacant and this invalidity could also affect a provision on the postponed effectiveness of the lease. On the other hand, recent case law of the Slovak Supreme Court has been more inclined to accept the concept of straightforward lease agreements with postponed effectiveness.

Future lease agreements are enforceable under Slovak law in the sense that the will of the breaching party may be replaced by a court decision if such party refuses to sign the lease agreement despite fulfilment of all agreed conditions precedent. Nevertheless, in order to ensure the enforceability of a future lease agreement, it is crucial to draft it very precisely.

It should be explicitly stated which party or parties are entitled to deliver the request to enter into the lease agreement. It should also be clear from the wording what the conditions precedent are for delivery of the request. A precise description of the logistics of delivery of the request and signing of the lease agreement can prevent later interpretation disputes. Most importantly, the parties must always agree on a time period within which the lease agreement is to be concluded.

About the author

Soňa Princová focuses her practice on real estate, general corporate and commercial matters, energy sector regulation and competition. She is a senior associate at Barger Prekop and has more than five years' experience working for international and domestic clients.

She has worked on many real estate acquisition transactions, as well as related corporate and project finance matters, and has represented clients in a number of green-field and brown-field freehold and leasehold acquisitions for retail and manufacturing purposes, including drafting of model documentation, title due diligence and zoning and construction permitting. She has advised on lease of office and retail space in a class A business and retail centres, including preparation of lease documentation and negotiations with individual tenants.

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Termination and extension

In general, lease agreements can be signed for definite or indefinite terms. Termination of indefinite term leases is flexible. Pursuant to the Act on Lease and Sublease, either party may terminate an indefinite term lease by delivery of three months' written notice without stating a reason, unless agreed otherwise. On the other hand, lease agreements concluded for a definite term are less easily terminated. The reasons for termination by notice before expiry of a definite lease term are expressly stipulated in the Act on Lease and Sublease.

The landlord may, for example, terminate the lease by notice if the tenant has not paid due rent or service charges for more than one month, or if it subleases the premises or a part thereof without the landlord's consent. The tenant may, for example, terminate the lease by notice if the landlord grossly violates its obligation to maintain the premises in a satisfactory condition for the agreed use.

The majority of the Slovak judiciary is of the view that the reasons for termination of a definite term lease by notice, as stipulated by the Act on Lease and Sublease, cannot be waived by agreement of the parties.

However, it is not clear whether such reasons, or mode of termination, can be extended. Case law (in particular, the decisions of Czech courts rendered at a time when the rules of termination by notice were the same under Czech and Slovak law) indicates that other means or modes of termination can be used as well. On the basis of such case law, the parties might be able to customise the conditions for termination of their lease agreement and depart from the rigid statutory rules under the Act on Lease and Sublease.

It is common for commercial tenants in Slovakia to require a prolongation option in their leases – an option to extend a definite lease term for another period upon request of the tenant. However, such options are not regulated under Slovak law and the legal status of such clauses is uncertain. If the option is to be fully enforceable, it should be drafted as an agreement on a future agreement, otherwise a violation of the option would entitle the injured party only to recovery of damages.

Vacation upon termination

Upon lease termination, landlords often face difficulties when tenants do not voluntarily remove their personal property from the leased premises. Under standard circumstances, the landlord would have to file an application for eviction of the premises with the court and wait until it receives a valid court judgment. However, court proceedings in Slovakia can drag on for years, and landlords, for commercial reasons, cannot afford to wait.

Therefore, parties to a lease agreement often agree on a specific mechanism for the vacation of premises at termination. For instance, if the tenant does not return the premises within a certain period, the landlord is entitled to remove the tenant's property and restore the premises at the tenant's cost. However, there is a risk to such conduct of which landlords must be aware. In some cases where the lease is terminated by the landlord due to the tenant's violation of the lease, the tenant may dispute the lease termination and require the court to issue a preliminary injunction. The preliminary injunction prohibits the landlord from evicting the tenant, or allows the tenant to use the premises until the dispute on the validity of the termination has been decided.

Although preliminary injunctions are rarely granted, if the landlord unilaterally vacates the premises without the tenant's consent, judges may be prompted by such conduct of the landlord to issue the preliminary injunction. In addition, even if a preliminary injunction is not granted, if the termination is later declared invalid the tenant will be entitled to recover damages caused by the unilateral eviction by the landlord.

"Asset deals involving commercial property leased to multiple tenants are usually avoided"

Technical improvements

Commercial premises are often delivered to tenants in shell and core condition. Tenants then proceed with their fit outs or construction alterations at their own cost and with the landlord's consent. Under Slovak tax law, such construction alterations are deemed to be technical improvements of the leased property, and tenants are entitled to deductions based on their related expenses.

If, upon termination of the lease, a tenant restores the premises and removes all technical improvements, no significant tax issues arise. If, however, the tenant fails to remove the technical improvements, landlords may face negative tax implications. Pursuant to Section 17(20) of the Slovak Income Tax Act, technical improvements abandoned by the tenant in the premises after lease termination represent landlord's in-kind income and increase its income tax base in the amount corresponding to the residual value of the technical improvements at the time of the lease termination.

In other words, even if the technical improvements have no commercial value for the landlord, they are considered to be landlord's income because they have become part of the landlord's building. In this regard, the landlord should oblige the tenant to vacate the premises at lease end as well as to provide a list of technical improvements made in the premises together with their acquisition values in order for the landlord to obtain an exact idea of the potential tax exposure.

Asset sales

Asset deals involving commercial property leased to multiple tenants are usually avoided in Slovakia due to several complications. With respect to leases, in an asset deal, the landlord and the potential purchaser face two significant issues: (i) tenants have the right to terminate their leases upon a change in ownership of the building (a right which is difficult to waive by contract); and (ii) it is uncertain whether the new owner assumes all the landlord's rights and obligations under the respective leases.

There is case law which suggests that only the basic attributes of the lease (leased premises, purpose and term of lease) are transferred to the new owner, while many ancillary provisions (such as the contractual penalties and arbitration clause) might not pass to the acquirer. It is yet to be seen whether courts will continue to uphold this view or refine the extent of transferred rights and obligations.